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Policies for Reforming Zaire's Shattered Economy

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Policies for Reforming Zaire's Shattered Economy

Abstract

This paper presents a brief overview of Zaire's political/economic history, followed by a section concerning the present economy, and finally, recommendations for Zaire.

Keywords

Africa, history, reform

About the author: Writing this paper for his Economics of Developing Countries class (Fall 1993), Matt Werner '94, a political science major, with a minor in economics, described the class as "challenging" and as being a very good complement to his personal interests in state and community level development. Matt had the opportunity to continue his in-depth study of Zaire in the following spring semester, in a U.S. foreign relations class where he focussed on the historic and political aspects of Zaire. Matt proceeds to Sangamon State University where he will begin his Master's degree in Public Administration, which he hopes to use as his stepping stone to a career in state government.

POLICIES FOR REFORMING ZAIRE'S SHATTERED ECONOMY

Matthew W. Werner

MEMORANDUM

TOs Prime Minister Etienne Tshisekedi Kinshasa, Zaire
FROM: Matthew W. Werner, Harvard University, Professor
of Developmental Economics, Independent Structural
Adjustment Consultant
REs Report on the restructuring/revitalizing of Zaire's
economy

9 December 1993

Dear Prime Minister Tshisekedi:

I have enclosed the report you requested. This study has been very difficult due to the rapid change occurring in your country. Also, it was very difficult gaining data from the Mobutu regime and the Bank of Zaire (the central bank).

As you are well aware, the situation in Zaire is dire. For all practical purposes, the economy has suffered complete collapse. I found this report to be quite challenging; because of this, I hope you find my recommendations helpful and that you are able to implement them when your government gains power.

I structured the report as you requested, with a brief economic/political history, followed by a section concerning the*] present economy, and finally, my recommendations for Zaire. In I the third section, I also delineated some of the political events that will also be necessary to implement, since the current political chaos is 95% of the problem. I have addressed the most] immediate issues that need to be handled first. There are simple too many problems to address in one report, since Zaire's economy is basically nonexistent. Progress cannot succeed until these

issues are dealt with. It will not be an easy process, but I do believe it can be done. Please feel free to contact me for advice and assistance.

These recommendations are made with the assumption that President Mobutu Sese Seko will resign or be ousted and that your government will assume its rightful place. Also, let me warn you that I tried at points in this report to add a little levity to make this subject a little easier to digest. Economics has the reputation of being "dismal", so this economist attempts to beat that label.

I. BACKGROUND HISTORY

Zaire's troubles cannot be ascribed to the Belgians who colonized and ruled it as the Belgian Congo, nor on the turmoil that existed between 1960 and 1964, which brought a United Nations peacekeeping force. The trouble can rightfully be placed in the hands of the man known as President Mobutu Sese Seko who seized control of the Democratic Republic of the Congo on November 24, 1965 and later renamed it, in 1971, the Republic of Zaire. His twenty-eight year autocratic, one-party reign has led to the near destruction of the Zairian economy.

From 1965 to the early 1970's, Zaire prospered, enjoying foreign investment. On November 30, 1973, Mobutu announced his policy of Zairianization. This policy not only changed the old colonial names of cities and geographic features to "proper" African names but also usurped control of the nation's plantations and companies operated by foreigners and turned them over to Zairians (Young & Turner, p. 171). This resulted in a slow-down in production because there simply were not enough Zairians trained to run these companies, not to mention that most of these firms were turned over as pay-offs to political allies and military officers (Young & Turner, p. 185). At this time, inflation was already high because of the oil crisis. In 1974 things began to worsen as world prices for copper, Zaire's main export, declined. Since then, prices have continued to decline and the economy of Zaire has declined with it.

The situation in Zaire has continued to deteriorate since the difficulties of the mid-70s. Since the 1970s, Zaire's debt has been rescheduled twelve times. Also, Zaire has failed to implement four out of five International Monetary Fund (IMF) macro policy agreements (Gulhati, 1990, p. 35). The debt burden and the continuing decline of copper prices has placed Zaire in a desperate situation.

As Zaire entered the 1990s, things began to unravel completely. On the political scene, Mobutu agreed to some democratic reforms. He allowed more political parties to compete with the official party of the state and held elections for the government. The December 1991 election for Mobutu's position as President was never held, however, and months after Prime Minister Etienne Tshisekedi was installed, Mobutu replaced him with a person of his choice (Walden, p. 2-3).

On the economic scene, the government's budget deficit has become an increasing problem. The government tried to solve this by financing approximately 98% of the deficit by printing more zaires, the national currency. This caused hyperinflation which reached over 2000% in 1992* Also, Zaire has been unable to pay any of its \$10 billion debt. This has led to a suspension of aid from the IMF and the World Bank. The United States, Belgium and France have also halted all aid to Zaire and are calling for Mobutu to step down.

The policies of Mobutu have brought financial disaster to Zaire and almost complete ostracization from the international community. With this background, the present day situation can be understood.

II. CURRENT STATE OF THE ECONOMY

In order to keep things concise, this section will describe the parts of the current economy that will be addressed by the policy recommendations in the third section.

First, the inflation problem mentioned above—in 1991, Zaire experienced an inflation rate of 4229% and 2730% in 1992, according to Mobutu's Prime Minister Faustin Birindwa in his address to the National Assembly on June 22, 1993. This has resulted because of the government's policy of financing the budget deficit by simply printing money. The deficit in 1992 reached 703 billion zaires—up from 22 billion zaires in 1991. The money supply increased from 886 million in 1990 to approximately 3,600,000 billion in 1993 (Walden, p. 4). Hyperinflation is not surprising with such a huge increase in the money supply in a short period of time. This hyperinflation has knocked a majority of Zairian consumers out of the formal economy and has forced them to revert to bartering for necessities. Banks have become almost completely useless, since people do not deposit what money they have because they must spend it quickly before it loses value. This in turn has resulted in a dependence on foreign investment, since the banks are unable to maintain accounts to lend. Thus, they have become non-functioning in the traditional role of financial intermediation. The zaires are basically worthless. An example can be found by looking at the exchange rate. In April, 1993, 2.5 million zaires traded for one U.S. dollar; now, eight months later, it is almost 12 million zaires per dollar (BBC, 30 November 1993).

On October 22, 1993, the government presented its new currency plan, announcing the creation of a new zaire which would equal 3 million old zaires. The phasing-in process was slated for one month but was extended to December 10, 1993 (BBC, 30 November 1993). What effect will this have on Zaire? None. All this accomplishes is to reduce the amount of zaires one has to carry around from three million to one; the currency is still worth the same as before.

Investment is the next area for consideration. As mentioned in the earlier section, investment in Zaire depends largely on

that from foreign nations. Hyperinflation threatens this in two ways. First, foreign investors do not want to put money into Zaire, because as soon as it is invested, it becomes devalued by inflation. Secondly, profits cannot be repatriated, and must be reinvested immediately before they lose value. Also, there is not enough foreign exchange available to import necessary equipment and other inputs for production. Yet another problem is the deteriorated infrastructure. The rail and road systems remain unchanged from colonial times. Transportation for a company can be costly.

One of the major obstacles to foreign investment and aid is the debt of Zaire which is approximately \$10 billion. It is currently unable to pay on the debt which has resulted in a major problem. The IMF and the World Bank have suspended all aid to Zaire until there is an improvement in the economy. The World Bank has suspended a program which would have improved the road system in Zaire and, thus, would have helped the transportation problem mentioned above. The most important ramification of this is that private and public lenders usually consider how a country stands with these two organizations when determining loans. With both suspending aid to Zaire, prospects for gaining loans are slim. On top of that, the U. S., Belgium and France have suspended all aid to Zaire until Mobutu is gone and a democracy is installed (ironic, considering that these nations, especially the U.S., helped keep Mobutu in power during the Cold War). Where will the money come from? If funds are being withheld by these sources, then what foreign investor will want to risk money in Zaire? Only the brave. Zaire must find some way to start making payments to regain status with the IMF and World Bank if there is to be any hope of an influx of foreign direct investment.

The current situation in Zaire's mineral sector is also troubling. Zaire has always been considered to be rich with natural resources, which in the past encouraged investment. Copper, cobalt and diamonds are the primary minerals mined and exported by Zaire (Kaplan, p. 214). Exportation of these minerals has been the primary source of foreign exchange through trade for Zaire. Due to the recent fall in prices of copper, diamonds have become the primary export. Production of these minerals and others has fallen drastically, thus further decreasing the amount of foreign exchange. If prices drop and you export less, then you make less money. Production has declined because of fuel shortages and the inability to acquire spare parts for machinery. Also, what is produced has a hard time getting to its destination because of the transportation system.

The various companies that mine the different minerals are either completely state-owned or owned by the state with members of the private sector. The only exception is oil firms which are mostly owned by foreign oil companies. Because of this strong government presence in the mining sector making decisions on political grounds, production has been further hampered. All

production decisions and hiring or promotions depend on politics instead of good, sound business. Nothing can be done to change the prices of these minerals on the world market, but production can be made more efficient in order to lower costs and increase profits.

The areas discussed here and their sub-issues in the economy are some of the most important to be addressed in order to move Zaire out of the corner into which past follies have led it. Now, it is time to consider solutions.

III. POLICY RECOMMENDATIONS

A. POLITICAL

Before economic concerns can be dealt with successfully, some political issues must first be addressed. First and foremost, Mobutu must be removed, either voluntarily or forcefully, and the democratically-elected government must take control. Until he is gone and democracy established, no progress can be made.

Second, this government must rally the people behind a unifying ideal, such as establishing a democracy. Writing a new, more democratic constitution could be the rallying point for the nation. This would help alleviate some of the ethnic unrest that has started to develop in the eastern part of the country. A national identity would help some of the transitions go more smoothly.

Third, the army must become loyal to the new government. Since they are currently not paid on time, a good start would be to reimburse them for what is past due. Control of the army should not rest in the hands of one or of even a few generals. This could easily result in a coup. A civilian or committee of civilians could be appointed as commander-in-chief. A code of honor for troops could be installed to insure that they respect the constitution and command structure; if they believe that the constitution is to be protected at all costs, then the likelihood of a charismatic general gaining their support for a coup is lessened.

Fourth, the new government needs to seek avenues to seize all assets of Mobutu and his family plus his elitist allies. Those assets have been illegally taken from the people of Zaire. The U. S., Belgium and France would probably be very helpful in this endeavor. Mobutu's assets have been estimated at approximately four billion U. S. dollars; their seizure could greatly help Zaire.

These are probably the most important steps to be taken politically in order to establish the stability needed for initiating any effective economic policy. The country most probably will have unrest with a change of government. It probably would be prudent to ask for the United Nations to provide assistance in the transition as soon as the new government takes power.

B. ECONOMIC

Dealing with inflation must be the number one priority in order to restart Zaire's comatose economy. This issue is never an easy one to address and has caused many a headache for financial ministers across the globe. However, the policy for Zaire can take greater risks since there is virtually nothing to lose.

The budget deficit and the government's policy of printing the money needed to cover the deficit have created the problem of hyperinflation. The government must first make it a policy to spend only an amount equal to its revenues. In most countries, this could be disastrous but not in Zaire. Unemployment is already estimated at 40%, so the shock will be minimal compared to the pain already being suffered. In Mobutu's government, it has been estimated that approximately 50% of the money allocated by the budget has been lost through corruption. This money has gone to Mobutu, who has kept a nice chunk for himself and has used the rest as pay-offs to political allies. The new government may not be corruption-free, but it should be less corrupt than in the past. That means that the deficit part of the budget, and a little more, was never available to the programs for which it was meant. It can be reasoned that these programs could remain at the same level of funding and possibly see a slight increase in funding. Also, the government must make it a policy to no longer print money as a mode for financing the deficit. This will be a non-issue once the financial system is operating, as long as the government commits itself to such a policy.

Wages need to be frozen for one year to prevent creation of inflationary pressure. This should help maintain the current level of employment. Even though wages would be frozen, they would lose worth much more slowly as inflation decreases.

Finally, concerning inflation, the government should restrict the growth of the money supply to a set percentage (low) for a set amount of time. One possibility would be an increase of no more than 1% per year for six years. This would allow time for the inflation rate to adjust from the changed policies and would help to prevent any inflationary actions in times of crisis. The government should also set a permanent ceiling for money supply growth after the adjustment plan to prevent the abuse of the money supply as has happened before.

With a policy in place and implemented to bring down the inflation rate, the IMF and World Bank would likely lift suspensions. Upon seeing that the new Zairian government is willing to do what is necessary to correct the mistakes of the past and to repay their debts, these organizations might be willing to help. Once these organizations return, other sources of aid and loans would be likely to reconsider assistance. The most immediate benefit would be the resumption of the road improvement project halted by the World Bank which would help to

improve the transportation problem.

The new government should next solicit aid from those nations, mainly the U. S., Belgium and France, which suspended it because of Mobutu. The aid requested should address social issues that need attention. Specifically, Zaire should set up a program to improve education and health care and to solicit aid for their support, with the understanding that Zaire would take control of the programs when it is able. Governments would be more likely to aid these types of programs, especially if given a time frame. This would free up Zaire's resources at the onset to deal with production issues. This social program should include the following points?

1. Money for medicine
2. Training of health personnel
3. Training of teachers
4. Reinstitution of the AIDS prevention program that was successful in Zaire in the mid-80's until funding ceased
5. Materials for primary, secondary and higher education

Next, the problems of foreign direct investment and mineral exports can be addressed simultaneously. First, all the parts of companies or complete companies owned by the state should be sold to private interests, especially to foreigners. This program should give tax breaks for five years to new owners as a period of readjustment, promise that firms will be given first priority to foreign exchange necessary to purchase inputs, provide tax incentives for companies who train Zairians in higher skills and management, and insure investors of safety from government seizure. This program would help bring in much needed foreign investment while improving the efficiency of the mineral sector through professional rather than political management as well as training Zairians in business and skills.

Another program should be formed to help foster the creation of firms that can link either forwardly or backwardly to the mineral sector. An example would be to get Caterpillar to locate a plant in order to provide machinery for road improvement projects, to build new factory sites, to provide mine equipment, and to improve Zaire's access to the Sub-Saharan market which will need such products for further development in the region. Also, Zaire could encourage a firm to process copper wire or cookware and firms that refine industrial or gem quality diamonds. Zaire could encourage this by giving these linked industries some of the same benefits extended to investors in existing firms. The program would include protection for each of those industries for a set period of time—possibly 5 or 6 years, tax breaks for that same period, foreign exchange priority access for inputs, low interest loans (once the banking system has started operation again), and improvement of transportation routes.

These policies would improve existing firms and encourage

new ones, resulting in the generation of more revenue from taxes, even with breaks, improving export revenues, increasing production and efficiency of the mineral sector, creating new jobs, and improving the skills of Zairian workers.

An overall policy for these firms concerning repatriation of profits should also be established. Firms should be allowed to repatriate profits if there is sufficient foreign exchange. The government should encourage firms to invest the money in Zaire. One possibility is the formation of a stock market as has been proposed by the current government (Birindwa, 1993). At this time, Zaire's financial market is not able to handle this, but in the future it could be a valuable tool to keep profits in the domestic market and encourage more investment from abroad.

Once these initiatives are taken, Zaire should be able to stabilize its economy and become productive. Furthermore, Zaire should be able to start repayment on its huge debt. A stable economy would also improve its chances at gaining further loans or rescheduling, though loans should be avoided as much as possible.

Overall, these policies could return Zaire to a stable state. By bringing inflation under control through controlled government spending, the entire business and economic climate would improve. Investors would begin to invest and aid would come. This, in turn, would allow improvement in the production of minerals and so on and so on. These first few changes would in turn bring changes to other parts of the economy. Things would start falling into place. But, this is just the beginning; many things remain to be done. Here is a brief list of areas that will need attention once the economy has stabilized-

1. Agriculture. Invest in this sector to prevent it from falling behind. Provide aid to improve techniques and technology so production can be increased. Ownership of land should be given to farmers to provide an incentive to produce. Zaire is diverse enough to have both an agricultural and industrial sector that is strong and productive.

2. Health care. This will need great attention even with the suggested social program in place. An AIDS epidemic promises to be socially and economically devastating.

3. Exchange rate. Set exchange rate as a crawling peg to prevent it from the great fluctuations of a floating rate but giving it some more flexibility than a fixed rate.

4. Development. Adopt an outward-looking strategy for development. Primary export strategy will not work since prices for main exports are declining. Foreign exchange is a must, so an import substitution strategy will not be effective either.

Zaire has great promise. Once it becomes economically and politically stable, it will develop well because of its vast resources. If Mobutu had never taken power, things may have gone better for Zaire, but no one will ever know. It still has the potential to develop into an economically strong nation with a large market. This potential promises that Zaire could be a major or the major economic power of the region. Only time will

tell.

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