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EBS/85/41
Correction 1

CONFIDENTIAL

March 4, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Mauritania - Request for Stand-By Arrangement

The following corrections have been made in EBS/85/41 (3/1/85):

Page 14: for "b. Monetary policy" read "3. Monetary policy"

Page 16: for "4. Public enterprises" read "5. Public enterprises"

Corrected pages are attached.

Att: (2)

is expected to shift from a deficit equivalent to 0.4 percent of GDP in 1984 to a surplus of 0.9 percent in 1985 (Appendix I, Table IV).

The consolidated deficit includes the public investment program, which is virtually fully financed externally, the expenditure financed by food aid, and foreign technical assistance financed through grants. Mauritania receives substantial amounts of foreign-financed food aid and technical assistance, which for 1984 and 1985 are estimated at 9.0 percent of GDP and 11.0 percent of GDP, respectively. In view of the high level of grants in the consolidated budget and the expenditures they finance, a devaluation has a negative effect on the consolidated fiscal position excluding grants (Appendix I, Table III). At an unchanged exchange rate, the consolidated deficit excluding grants would have declined from 24.5 percent of GDP to 19.3 percent. After account is taken of the exchange rate action, however, the deficit on this basis is projected at 21.8 percent of GDP.

Taking into account the elimination of outstanding domestic and external arrears in 1985, the consolidated deficit on a cash basis is expected to rise from 7.7 percent of GDP in 1984 to 17.1 percent in 1985. This deficit is expected to be financed through disbursements associated with the public investment program and through debt relief and additional exceptional assistance; domestic bank financing will not increase as the statutory ceiling on credit to the Government has already been reached.

Total receipts are projected to increase by 24 percent, reflecting a 30 percent increase in grants and a 19 percent increase in domestic revenue (Appendix I, Tables III and V). The latter is mainly due to the effects of the depreciation, which is expected to substantially boost customs duty receipts, the introduction of new tax measures, and improvements in tax administration. The major new tax measures approved by the Government in the 1985 central government budget include the conversion of specific taxes on tobacco, milk, tomato paste, and edible oil to an *ad valorem* basis, the revision of customs duties in line with those of the Community of West African States, and the revision of the threshold for using the lump-sum system for business profit taxes (BIC). Domestic revenue is also projected to benefit from an expected improvement in fishing sector activity. In addition, the Government expects to improve tax collection in the fishing sector through the newly-created fish marketing company (SMCPP). Tax administration will be strengthened in order to improve collection of wage and salary taxes (ITS), of the general income tax (IGR), and of delinquent taxes.

On the expenditure side, notwithstanding the exchange rate action, total consolidated expenditure is projected to grow by only 11 percent in 1985 as against 18 percent in 1984. The growth in budgetary current expenditure (excluding interest payments on public debt) will be limited to 7.4 percent (Appendix I, Tables III and VI). This will be achieved in part by containing the growth in the wage bill. Civil service salaries, which were already reduced by 13 percent in real terms during the period 1980-84, will be further reduced in real terms in 1985, as a general cost-of-living adjustment of only 2 percent will be granted. Recruitment in the last quarter of 1984 is estimated to account for an addition of 3 percentage points to the wage bill, while the wage drift is estimated at 2 percent. As the size of the civil service will be frozen at the end-1984 level in 1985, the overall wage bill will not be allowed to grow by more than 7 percent. Although cuts in real terms in nonwage expenditures were implemented in 1984, the Government intends to maintain expenditures on equipment, maintenance and supplies constant in real terms. Subsidies and transfers will be maintained at the 1984 level in nominal terms, implying a reduction in real terms. In addition, government investment expenditures will be reduced in domestic currency terms by 23 percent, reflecting the overall reduction in the public investment program.

As a performance criterion, domestic arrears, presently estimated at UM 742 million, will be reduced starting in March 1985 by quarterly amounts of UM 185.5 million. No new domestic arrears will be incurred during the program period. A comprehensive survey to determine if additional domestic arrears are outstanding will be completed before the mid-term review, at which time a schedule will be agreed upon for the elimination of all domestic arrears by the end of the program.

3. Monetary policy

The Government will continue with a restrictive monetary policy consistent with the balance of payments and budgetary objectives. Accordingly, credit expansion in 1985 will be limited to 5 percent compared with 8.6 percent in the previous year, and will be provided exclusively to the nongovernment sector, while no increase in net bank credit to the Government will be allowed for the whole year (Appendix I, Table VII). This implies that net credit to the nongovernment sector will increase by 7.0 percent in 1985 as against 12.0 percent in 1984, with priority to be given to vital economic sectors, such as agriculture, fishing, and mining.

As performance criteria, quarterly ceilings on total domestic credit and on net credit to the Government were established for end-March 1985 and end-June 1985. On an indicative basis, corresponding credit ceilings were set for end-September and end-December and performance criteria for these two quarters will be established during the mid-term review of the program scheduled before end-July 1985, taking into account the progress made under the program, the outcome of external debt rescheduling, and any additional nonproject related budgetary external assistance.

In order to improve resource allocation and strengthen financial intermediation, the authorities are raising the interest rate structure on February 28, 1985 by a minimum of 2 percentage points (Appendix V, Attachment II). Accordingly, interest rates on deposits are now in the range of 7-11 percent, and lending rates on rediscountable and non-discountable loans have been increased to a range of 8.5-12 percent and 12-16 percent, respectively, in line with the underlying inflation rate, about the average annual inflation rate recorded during 1982-84. The appropriateness of the interest rate structure will be reviewed at the time of the first review of the program.

Financial intermediation is also expected to be improved through a comprehensive rehabilitation of the banking system. A study financed by the Arab Monetary Fund is under way; a timetable for implementing the study's recommendations will be agreed upon at the time of the mid-term review. In the meantime, credit risk assessment procedures will be strengthened with a view to avoiding a further accumulation of domestic arrears to the commercial banking system. Further, to improve statistical recording of banking transactions, the recommendations made by a recent Fund report on statistical issues relating to monetary data will be implemented and the progress reviewed during the mid-term review of the program.

4. Pricing and marketing policies

With a view to stimulating private sector economic activity and improving resource allocation, the Government will progressively liberalize pricing and marketing policies and increase official prices for consumer goods, public utilities, petroleum products, and agricultural producer prices, to reflect at least the full pass-through effects of the exchange rate adjustments on prices. On February 15, 1985, the Government took a number of measures. The floor producer price of sorghum, maize, and wheat paid by the Commissariat à la Sécurité Alimentaire (CSA) was raised, in accordance with the proposals of the World Bank, from UM 15 per kg to UM 21 per kg, and that of paddy rice from UM 12.5 per kg to UM 14 per kg. This measure aimed at encouraging domestic cereal production, reducing cereal imports, and compensating for the phasing out of fertilizer subsidies by 1986. Concomitantly, the wholesale price of sorghum, maize, and wheat sold by CSA was increased in accordance with the proposals of the World Bank, from UM 15 per kg to UM 22.5 per kg in Nouakchott, and from UM 14 to UM 21.5 per kg in the rest of the country. While there is no explicit budgetary subsidy involved, given that these commodities are mostly received as grants, semi-annual adjustments will be made to achieve by 1987 import parity for these commodities, currently estimated at UM 27 per kg after the February 15, 1985 devaluation. In addition, the price of broken rice marketed by SONIMEX in Nouakchott was raised from UM 20 per kg to UM 26 per kg. Prices for other cities and regions will fully reflect the additional costs of transportation and marketing.

In view of the flexible exchange rate policy that is being pursued, directives have been given that official prices, including those for petroleum products, as well as charges of public utilities be fully adjusted for any exchange rate action at the latest within four weeks.

To ensure prompt adjustments, the Government plans to establish a mechanism to effect these adjustments automatically. The mechanism being considered will be examined at the time of the mid-term review of the program.

To provide a basis for the gradual liberalization of pricing policies, the Government is initiating a study to determine the appropriate changes in the current pricing system. Under the current system, the prices of basic commodities are fixed by the Government, a profit margin for imported goods is set, and only the prices of luxury goods are determined freely. The study will attempt to define which basic commodities, the prices of which are currently determined by the Government, can be allowed to be priced through the market mechanism, which imported commodities, subject to profit margins, can be moved to be priced in the market, and the extent to which profit margins on imported goods can be widened. Concurrently, the marketing arrangements are being reviewed to determine the modalities by which private sector participation can be expanded. In this regard, food marketing and production policies will be defined, by reviewing the role of CSA, SONIMEX, SONADER, and the rice mills. The results of the analysis will be examined at the time of the mid-term review with a view to formulating specific measures to be put in place during the second half of the program period.

5. Public enterprises

The Government initiated in late 1983 a reform of the public enterprise sector in cooperation with the World Bank and other donors. The reform is expected to continue in 1985. In 1984, two key public enterprises, the National Mining and Industrial Company (SNIM) and the National Rural Development Agency (SONADER) started implementing individual rehabilitation plans. In addition, rehabilitation programs to reform the electricity and water supply company (SONELEC), the Nouakchott port authority (EMN), and the post office and telecommunications agency (OPT) were formulated. World Bank financing of US$16.4 million for public enterprise technical assistance and rehabilitation has been negotiated. Total concessional financing committed, which amounts to US$11.6 million, involves participation of the Caisse Centrale de Coopération Economique, the Fonds d'Aide et de Coopération (FAC), the European Development Fund (EDF), the European Investment Bank (EIB) and Kreditanstalt für Wiederaufbau (KfW).

It is expected that in 1985 the public enterprise sector will benefit from a number of measures implemented in 1984. These include an improvement in the legal framework governing public enterprises, the delineation of responsibilities of boards of directors, and the introduction of a new accounting framework. In order to monitor the implementation of reforms under way in the public enterprise sector, the Government established a unit within the Ministry of Plan; monitoring units within the technical ministries are expected to be established in 1985. The Government also completed in 1984 a preliminary study on interlocked debts between the