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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 99/76

11:15 a.m., July 12, 1999

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

M. Camdessus, Chairman
A.D. Ouattara, Acting Chairman
S. Sugisaki, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	S.M. Al-Turki
A. Barro Chambrier	D. Ondo Mañe
T.A. Bernes	
	M.J. Fernández Garcia, Temporary
R.F. Cippà	W. Szczuka
B. Esdar	W.-D. Donecker
N. Eyzaguirre	A.G. Zoccali
R. Faini	J. Spraos
	G. De Blasio, Temporary
K.A. Hansen	O.-P. Lehmussaari
K.-T. Hetrakul	C. Harinowo
W. Kiekens	
K. Lissakers	
J.-C. Milleron	E. Jourcin, Temporary
A. Mirakhor	M. Daïri
	M.R. Shojaeddini, Temporary
J.P. de Morais	J. Mafararikwa, Temporary
A.V. Mozhin	
S. Pickford	S. Collins
M. Portugal	O.L. Bernal
A.S. Shaalan	A.F. Al-Faris
	S.A. Bakhache, Temporary
M.R. Sivaraman	A.G. Karunasena
G.F. Taylor	
Wei Benhua	Zhang F.
	Luo Y., Temporary
J. de Beaufort Wijnholds	Y.G. Yakusha
Y. Yoshimura	M. Takeda

R.H. Munzberg, Secretary
J. Prust, Acting Secretary
C. Andersen, Assistant
S. Djumena, Assistant

Also Present

IBRD: M.A. Ayub, Africa Regional Office. African Department: E. Hernández-Catá, Associate Director; A. Basu, Deputy Director; S.M. Darbar, M.-F. Desclercs, I.A.H. Diogo, S. Fabrizio, C.A. François, E.C. Harris, H. Hino, G. Kalinga, P. Ramlogan, J.T. Reitmaier, P. van den Boogaerde, A.B. Zorome. Asia and Pacific Department: W.S. Tseng, Deputy Director. External Relations Department: Mboto Fouda. Fiscal Affairs Department: V. Tanzi, Director; D.M. Simard. Policy Development and Review Department: S. Chami, L.J. Lipschitz, J. Seade. Secretary's Department: A.S. Linde, Deputy Secretary, P. Gotur, A. Mountford. Technology and General Services Department: B.C. Stuart, Director. Western Hemisphere Department: C. M. Loser, Director. Office of the Managing Director: M. Cross, Personal Assistant; D.A. Citrin, J.A.P. Clément, E.-A. Conrad, N. Sachdev, S. Tiwari. Advisors to Executive Directors: P.A. Akatu, M. Askari-Rankouhi, L.J.F. Erasmus, S.S. Farid, O.A. Hendrick, J.M. Jones, B. Konan, M.F. Melhem, H. Mori, Nguyen Q.T., J. Ntamatungiro, A.R. Palmason, Y. Patel, M. Sobel, T. Turner-Huggins. Assistants to Executive Directors: E. Azoulay, J.G. Borpujari, P.A. Brukoff, N. Burnashev, P. Cabezas, J. Chelsky, I.-K. Cho, V. Dhanpaul, R. Djaafara, E. González-Sánchez, T. Hadded, M.R. Hajian, K. Harada, M.S. Hililan, I.C. Ioannou, N. Joicey, C. Josz, A. Kapteijn, K. Kask, S.K. Keshava, B. Killen, E. Kornitch, K. Kpetigo, D.H. Kranen, T.-M. Kudiwu, K. Lai, D. Nardelli, J. Nelmes, Peh K.H., V. Rigász, S. Rouai, S. Sharipova, S. Vtyurina.

1. SENEGAL—ENHANCED STRUCTURAL ADJUSTMENT FACILITY—SECOND ANNUAL ARRANGEMENT

The Executive Directors considered Senegal's request for the second annual arrangement under the Enhanced Structural Adjustment Facility (EBS/99/114, 7/1/99), together with a policy framework paper for Senegal for the period 1999–2001 (EBD/99/78, 7/1/99).

Mr. Barro Chambrier made the following statement:

Following the successful implementation of comprehensive reform programs with the support of the Fund, over the past five years, Senegal continued to make significant progress in its economic reforms under the first annual program supported by a new three-year ESAF arrangement. Indeed, economic performance improved considerably.

Despite adverse weather conditions that reduced agricultural sector production, real GDP is estimated to have grown by 5.7 percent, boosted mainly by a strong recovery in peanut oil milling, construction and public works, and increased development in service sector activities. Inflation was reduced to about 1.0 percent and the external account deficit, at 6.8 percent, was lower than programmed, on account of the decline in interest payments on rescheduled debt.

In the fiscal area, revenue-increasing measures included in the 1998 and 1999 financial laws were implemented and control over expenditure was strengthened. Consequently, tax revenues increased by about 9 percent to reach 15.9 percent of GDP, while current expenditures were reduced by more than 2 percent. At the same time, the government continued to allocate substantial budgetary resources to the health and education sectors. In 1998, budgetary appropriations to these sectors increased from 33 percent to 36 percent of total current spending. Regarding capital expenditure, the rise of 20 percent in 1998 reflects new investments, but also the inclusion in the fiscal accounts of data on 1994–98 foreign-financed investment expenditures on which data has now become available. With this adjustment, the ratio of the overall deficit (excluding grants) to GDP increased from 2 percent in 1997 to 3.3 percent in 1998. However, excluding the newly reported foreign-financed investment, the deficit declined by 0.6 percentage point of GDP to 1.1 percent of GDP in 1998.

The monetary policy conducted at a regional level was prudent and was directed at maintaining price stability and at building up the foreign exchange reserves of the monetary union. To that end, net credit to the government and the growth in broad money remained in line with program projections. Moreover, Senegal made a substantial contribution to the increase of the net foreign assets of the central bank of the West African Monetary Union (WAMU). Furthermore, the banking system remains broadly sound and complied largely with the prudential ratios of the regional banking commission.

Efforts were intensified in the area of structural reforms in order to improve the business environment for the private sector and lay the foundations for good governance. The first phase of reduction in tariffs in the context of the West African Economic and Monetary Union (WAEMU) was completed: the unweighted average assessed duty rate was lowered from 19 percent to 16.3 percent on non-Western African Economic and Monetary Union dutiable imports and the number of tariff discounting mechanisms (précisions tarifaires) was substantially reduced. Moreover, petroleum products marketing and pricing were fully liberalized. Also, five enterprises were sold or liquidated, out of the 13 set for privatization, and the activities of the urban transportation company (SOTRAC) which had been already liquidated in November 1998 are to be taken over by a private company. Furthermore, the important structural reforms implemented in 1996–98 have contributed to improve significantly the business environment for the private sector. In order to modernize the business laws, new provisions for arbitration were prepared and an arbitration court was set up in the Chamber of Commerce of Dakar. Finally, the functioning of the legal and the judiciary systems was improved as new magistrates and clerks were recruited and trained. In the area of governance, the consumer survey on the quality of services was completed.

Despite these substantial achievements, my Senegalese authorities share the view that many areas of weaknesses remain which require further action to consolidate gains achieved in the reduction of financial imbalances, accelerate the reform process, and reduce poverty. In that perspective, based on encouraging results achieved in 1998, objectives and strategies for 1999–2001 were updated, and a second annual program has been prepared for 1999–2000. This economic program, in support of which the Fund assistance is requested, seeks to achieve a real GDP growth of 6.4 percent, maintain inflation under 2 percent and reduce the external current account deficit to below 7 percent of GDP.

The strategy envisaged by the government will be based on further fiscal consolidation, including the pursuit of adequate allocation of resources to priority sectors in order to improve social indicators, prudent monetary policy, strengthening economic competitiveness, and deepening the structural reforms. The latter includes the continuation of public enterprise sector restructuring, efforts to promote private sector development as well as governance and transparency issues. My authorities are also convinced that domestic savings and investment need to be raised in order to achieve a sustained growth and a lasting reduction of poverty and unemployment.

Fiscal policy under the program aims at increasing public sector savings through a continued reform of the tax system and a strengthened control over expenditure. On the revenue side, the major action will be the continuation of tariff reform in the framework of the harmonization of the common external tariff (CET) within the Western African Economic and Monetary Union. Indeed, during 1999-2000, the authorities envisage to complete the rationalization of import surcharges and minimum values and to eliminate the précisions tarifaires, consistent with the arrangement agreed by the Council of Ministers of the Western African Economic and Monetary Union. In the same vein, the customs duty on the highest import category will drop from 25 to

20 percent, and a 1 percent statistical tax will replace the 5 percent customs stamp duty. The impact of the common external tariff is estimated at about 1.0 percent of GDP. Consequently, to offset revenue losses, the government intend to implement additional revenue-increasing measures, including the uniformization of the value added tax at the single rate of 18 percent and the expansion of its base, notably through a curtailing exemptions. Other measures envisaged include the expansion of the use of the single taxpayer identification number and the strengthening of the customs and tax administrations. As a result, revenue is expected to stabilize at 16.8 percent of GDP in 1999.

On the expenditure side, the government will continue to control current expenditure. The size of civil servants will remain unchanged over the program period except for recruitments needed for priority sectors, while the wage bill is expected to grow moderately. In addition, the authorities will implement during the program period and for the first time, a wage system which combines automatic and merit increases elements; as a precursor for a full merit-based wage system to be introduced at a later stage. They are also committed to use any savings achieved on wages and non-priority current outlays to increase the share of appropriations going to social sectors in the 1999 operating budget. On average, capital expenditure will increase in line with nominal GDP. The government will take steps to fully implement the action plan for improving the preparation and execution of the investment budget.

On monetary policy and financial sector reform, the Central Bank of West African States (BCEAO) will conduct at a regional level, a prudent monetary policy consistent with the regional inflation and balance of payments objectives. The authorities will continue to work toward improving the indirect instruments of monetary policy and encourage the development of the secondary markets in treasury bills and central bank papers. My authorities intend to expand mutual savings and loans network in rural and urban areas, and diversify savings instruments in order to improve the mobilization of domestic financial savings. Moreover, in line with the decision of the Western African Monetary Union's Council of Ministers, the government is committed to eliminate gradually the outstanding central bank credit to the government. As regards the soundness of the banking system, the Senegalese banking system continue to remain generally sound; the authorities, however, are committed to ensuring that all prudential ratios of the Western African Monetary Union Banking Commission are respected by the banking system, and will improve the functioning of commercial courts and procedures to recover collateral for bank loans.

The authorities share the view that the deepening of structural reforms is essential to speed up the private sector-led growth. In that context, to intensify the reform of the public enterprise sector, 13 public enterprises operating in various sectors will be put up for sale in 1999, while five others will be ready for privatization in 2000. After the completion of these sales, the very small number of public enterprises remaining in the government's portfolio will continue to be restructured and strengthened.

Structural reforms include also private sector development and investment promotion. To that end, the government is committed to improve the functioning of the one stop window for investors and to reduce the multiple sectoral approvals and registrations. Moreover, as regards the improvement of the legal environment and the performance of the judicial system, the modernization of the commerce tribunal is under way while new recovery and enforcement procedures are scheduled to be presented to parliament for adoption. The national program of good governance remains a top priority in the government's strategy for 1999. In that context, and with a view to fighting corruption and all forms of fiscal fraud, fishing licences will be granted according to fully transparent procedures. In the same vein, the transactions of the fund for economic promotion (fonds de promotion économique) will be audited and finalized before end-year.

Beyond these measures, my authorities are concerned by human resources development and poverty alleviation. Concerning human resources development, although the government's strategy is scheduled to be implemented throughout the program period, actions envisaged in the health and education sectors for 1999-2000 include, among others, the improvement of performance indicators, the increase of capacity absorption of the ministry of health, the adoption of a corrective plan for the reform of higher education, a definition of a hiring policy for teachers, and the strengthening of women's status. Regarding poverty reduction, the government intends to intensify supporting measures aimed at creating micro-and small size enterprises, and accelerate labor-intensive projects.

In 1998, Senegal benefitted from the stock of debt reduction operation granted by Paris Club creditors. The government has taken steps to conclude bilateral agreements with most of these creditors before the deadline. Discussions are under way with non-Paris Club bilateral creditors to secure debt relief on at least the same terms. However, additional assistance from bilateral and multilateral donors and creditors will continue to be needed to support the reform process, and achieve the program objectives. In that context, in line with the guidelines of the Cologne summit, my authorities are hopeful that Senegal could benefit from the enhanced HIPC Initiative.

Finally, my Senegalese authorities would like to reiterate their strong determination to pursue adjustment policies during the years ahead. They are confident that a steadfast implementation of these measures will help achieve sustainable growth and improve the living conditions of the population.

Mr. Jourcin made the following statement:

I am pleased to note that, as in recent years, Senegal has continued to maintain a sound macroeconomic policy stance during the first annual program supported by the ESAF. As a result, economic performance was satisfactory, with strong real GDP growth, weak consumer price inflation and a reduced external current account deficit. Furthermore, fiscal developments were in line with the program and progress on structural reforms has been made in several areas. Let me commend the Senegalese authorities for their successful efforts.

Given this positive background, and since I fully share the staff's appraisal, I can be brief and raise only a few points:

First, I welcome the government's intention to reduce its indebtedness to the banking system during the coming years, thanks to privatization receipts. I note that there will be a repayment of 9 billion CFA Francs to the Central Bank in 1999, and that the stock of domestic public debt is expected to be reduced by more than 5 percent of the GDP by end-2001. This will contribute to strengthen fiscal viability.

Second, as for the implementation of the common external tariff at the regional level, I would like to underscore that all impediments will have to be removed without delay, in particular by eliminating the "précisions tarifaires". In this regard, I am somewhat disappointed that the reform of the value added tax, including the introduction of a single rate, has been postponed until July 2000. Indeed, this reform is an important element of the efforts that are made to compensate for customs revenue losses. This delay could fragilize the implementation process of the common external tariff.

Third, the authorities have adopted an ambitious structural reform agenda for the period ahead, which is crucial to promote private sector-led growth. I am pleased with this acceleration in the structural area, because the pace of reforms was sometimes a weakness in the past performance.

Fourth, I support the staff's recommendations regarding governance and transparency issues, including the fight against corruption. In Senegal, there is room for improvement in this area.

Fifth, there is also room for improvement as for the statistical data base and efforts should be pursued in this domain. As well, staff rightly underscores that the authorities should ensure that Senegal's computer systems are ready for the year 2000 issue.

Finally, maybe a question for staff, regarding ongoing negotiations with non-Paris Club bilateral creditors. Could staff provide us with more information on the status of these negotiations?

With these remarks, I approve the proposed decision and wish the Senegalese authorities the best in their endeavors.

Mr. Al-Turki made the following statement:

Senegal's adjustment and reform efforts continue to make impressive progress. Last year, growth picked up and inflation slowed with fiscal policy broadly on track and improvements in the external accounts. Structural reforms also continued, though with some delays. The outlook remains positive with growth set to pick up in an environment characterized by low inflation and strengthening fiscal and external payments positions. Given the authorities' continued policy resolve, I can readily support the proposed second annual arrangement under the ESAF.

I broadly agree with the staff appraisal and will only underscore a few key policy priorities.

First, I welcome the emphasis on further fiscal consolidation with a focus on meeting current spending with current receipts. I am encouraged by both the shift in revenues from tariff dependence to reliance instead on a broadened value added tax and the envisaged increase of spending in priority areas. For lasting fiscal gains, it is crucial to improve spending controls and accelerate reform of the civil service, including early transition to a fully merit-based compensation system. Finally, let me note that the increased reliance on public savings for financing the anticipated rise in public investments bodes well for prospects of sustained growth.

Second, the program's privatization time table is appropriately ambitious and I endorse the authorities' strategy of limiting public enterprises to tasks unlikely to be assumed by the private sector. Here, the staff is right to emphasize the importance of ensuring a business-conducive legislative and regulatory environment. In that connection, I urge the authorities to not only step up the ongoing reforms but also to act on staff advice and adopt a comprehensive action plan to address the factors inhibiting private investments in Senegal.

Third, I agree with Mr. Barro Chambrier that Senegal's reform process will continue to require the international community's support. I am therefore looking forward to the staff's reassessment of the country's position under the proposed enhanced HIPC Initiative. The authorities' commitment meanwhile to limit further borrowing to highly concessional loans and grants is appropriate.

With these remarks, I wish the authorities continued success.

Mr. Karunasena made the following statement:

The Senegalese authorities have continued their efforts to improve macroeconomic management and address structural reforms necessary to strengthen the growth prospects of the economy. Implementation of the first annual program under the present ESAF-supported program has been satisfactory, though there were delays in the completion of some structural reforms. The economy has responded positively by recording increased growth, lower inflation and a reduced external current account deficit in 1998 despite unfavorable weather conditions. The authorities are to be commended for these achievements. However, much still needs to be done as the economic and financial situation remains fragile. Further measures to consolidate the recent achievements are required to improve the resilience of the economy and achieve a sustainable growth sufficient to address the poverty problems effectively in the medium term.

The proposed second annual program seems to be another major step in their efforts to improve growth prospects while maintaining macroeconomic stability and strengthening the external position of the country. The program seems to be ambitious, particularly with regard to intended structural reforms requiring strong commitments and continuous efforts of the authorities.

It is encouraging that the projections for 1999 indicate a further increase in economic growth, and low inflation. However, the external sector current account deficit is projected to decrease only marginally even in the medium term, and thus requires prudent external debt management policies.

We commend the authorities for their prudent utilization of privatization proceeds largely to eliminate outstanding extra-budgetary arrears, reduce public debt and finance the restructuring of public enterprises, which have been singled out for privatization. It would be appreciated if the staff could explain whether measures have been incorporated in the present program to prevent the future accumulation of extra-budgetary arrears. It is encouraging that government expenditure is allocating more resources for human development—mainly for education and health.

As further improvements in the fiscal balance is crucial in order to facilitate prudent monetary management under the existing regional exchange rate and monetary arrangement, we urge the authorities to take additional (and necessary) measures to cover the government revenue gap that is expected during the implementation of tariff reforms and the unification of tax rates under the value added tax system. Despite intended fiscal consolidation in the medium-term, domestic deficit financing from the banking system will increase in 2000. Staff comments would be appreciated.

Intended developments in market-oriented indirect monetary measures would facilitate future monetary management, while further improvements in financial sector supervision and regulations are crucial in order to strengthen the financial system.

Early successful completion of the debt restructuring negotiations with non-Paris Club bilateral donors would be useful in further strengthening the external debt sustainability of Senegal.

Implementation of the structural reforms that are envisaged under the program is necessary to improve resource allocation efficiency and productivity and, hence, achieve medium-term sustainable high growth targets. Close and continuous monitoring of the implementation of structural reforms is crucial in preventing potential downside risks particularly during the pre-election period in 2000.

The report does not contain information on the labor market developments, except details on intended reforms in the civil service. Staff views, if any, on the unemployment situation and labor market flexibility would be appreciated.

With these remarks, I support the proposed decision and wish the authorities success in their efforts.

Mr. Bakhache made the following statement:

The strong reform agenda pursued since 1994 has been yielding significant gains for Senegal, as evidenced by the continuing improvement in the macroeconomic environment. In 1998, economic growth was maintained in a low inflation environment in spite of a decline in the agricultural sector, and both the external current account balance and the basic fiscal balance were better than programmed. Looking ahead, the challenge for the authorities will be to strengthen the financial stability achieved so far, in order to place the economy in a position to benefit fully from the ongoing efforts aimed at enhancing the role of the private sector and further improving social indicators. Key to achieving this objective, as well as higher growth, is perseverance with fiscal consolidation and the removal of rigidities in the economy, while addressing the needs of the social sectors.

We support the request for the second-year ESAF arrangement to support Senegal's program, which addresses these issues, and urge the authorities to stay the course of reform during the critical period leading up to the presidential elections. We are in general agreement with the staff appraisal and would like to highlight two key areas which we believe should be accorded high priority.

The authorities deserve to be commended for progress on the fiscal front over the past few years. The ability to maintain the revenue to GDP ratio at just over 16.5 percent despite the reduced tariffs associated with trade liberalization is noteworthy. This ratio, however, remains and is, in fact, projected to remain relatively low over the next two years. This clearly underscores the importance of pushing ahead with measures to improve revenue performance over the medium term, especially in light of the need to keep provisions for adequate financing of the social sectors and infrastructure. The introduction of a single rate of value added tax in July 2000 is certainly an essential step in this regard. Here, we wish to emphasize the importance of keeping exemptions to a minimum, as it becomes very difficult to rescind those once they have been put in place.

Regarding efforts to promote the role of the private sector, we are encouraged by the progress under way in the privatization of the remaining public enterprises, and the plan to withdraw the government from commercial activity before the end of 2000. Like the staff, we believe that liberalizing the energy and transport sectors and emphasizing the development of human resources would enhance efficiency. However, we gather from reading the staff report that impediments to private sector activity remain, and in this regard we very much welcome the efforts to improve the judicial and legal systems, and encourage the authorities to implement the reform measures without delay.

We note that the government is in the process of preparing a development strategy to promote private sector activity, and would appreciate the staff's views on the stage of development of this plan and its effectiveness in addressing the factors that inhibit private investment activities.

With these remarks, we wish the authorities every success.

Mr. Donecker made the following statement:

At the outset, I would like to say that we too support the staff's appraisal and the proposed decision. Senegal's achievements, which are the result of prudent implementation of the ambitious reform program, are remarkable. Economic growth has been strong, and inflation has been reduced. Due to the decline in interest payments, the external current account deficit has been lower than estimated. However, economic performance could have been better, and there are still some areas in which the authorities should strengthen their efforts. For instance, there is more room for fiscal consolidation. Let me clarify this.

Due to the 1999 supplementary finance law, which comprises more expenditures, the surplus of the budgetary balance will be reduced to 1.7 percent of GDP—a third less than projected in the original budget. The budgetary balance will also be somewhat smaller than projected for the year 2000. While keeping in mind the likely loss of revenue due to trade liberalization and delays in containing current expenditure, we would accordingly have preferred to see the authorities adhere to the original program targets. We are also concerned about the six month delay in adopting the planned value added tax reform, which will cause a potential revenue loss of 0.4 percent of GDP, and we therefore recommend that the authorities reconsider this decision.

On the expenditure side, we share the staff's view that reform of the merit-based promotion system of the civil service is very important. However, the implementation of this reform was planned already for last year, and we accordingly hope that more than a first step will be taken during this year.

Finally, I would like to express my hope that the coming presidential elections will not cause postponement of critical reforms, especially in the structural area. The government of Senegal has been following an overall prudent economic policy, which has delivered compellingly positive results. This should encourage the authorities to resist such temptations.

Mr. De Blasio made the following statement:

We welcome the opportunity to review the economy of Senegal. During the first year of the program, the Senegalese authorities implemented sound macroeconomic policies, which were key in assuring good growth performance despite adverse weather conditions. Lower inflation and a reduction in the external current account deficit relative to GDP are other worthy achievements. The authorities are also to be commended for maintaining the fiscal stance and implementing a number of fiscal reforms, as summarized in box 1 of the staff report. However, it is important to stress that the tight fiscal stance should be maintained and the structural reforms in this area accelerated, in order to reach high and persistent growth rates. Since I agree with the staff appraisal, I will limit my comments to two points that I see as crucial for promoting sustainable growth.

Firstly, regarding the development of human resources, it is well-known, and also recognized in the Policy Framework Paper, that social indicators for education and health are still modest. While we appreciate the fact that budgetary allocation in this area increased in 1998, we also noted that the supplementary finance law in 1999 did not make any further allocation "because of significant delays encountered in previous years in spending the regular budgetary allocations." Although we welcome the decision by the government to prepare a report to tackle such bottlenecks, we would appreciate some comments from the staff. In particular, we would like to know if the choice not to provide any additional financing to the education and health sectors can be seen as appropriate and. More generally, we would like to know how strong the authorities' commitment is on this issue.

Secondly, this chair has repeatedly emphasized that good governance and property-right assurance are crucial for economic growth. We deem the importance assigned by the staff to this issue as entirely appropriate. In this vein, we urge the authorities to accelerate the reform of the legal and judicial system. Moreover, we look forward to seeing concrete steps towards the implementation of the authorities' program aimed at fighting corruption. Finally, given the importance of the fishing sector to the economy, we urge the authorities to readily assure full transparency in granting fishing licenses.

With these remarks, I wish the authorities success in their future endeavors.

Ms. Fernández made the following statement:

The Senegalese authorities should sincerely be congratulated for their continued remarkable economic performance. The first annual arrangement under the current three-year ESAF arrangement has been successfully completed, which has made possible to advance considerably the objectives of the program, namely, the promotion of strong and sustained economic growth; the reduction of poverty; and the reinforcement of domestic and external viability. I would like to commend the staff for designing a comprehensive but well balanced economic program, and for the good set of papers it has presented for today's discussion.

I certainly agree with the thrust of the staff appraisal, and am glad to support the approval of Senegal's program for the second annual arrangement under the ESAF. I base my judgment, on the one hand, on the authorities' satisfactory track record of adjustment and reform and, on the other hand, on their sound medium-term strategy.

Indeed, during 1998, the economy registered a solid 5.7 percent GDP rate of growth, which, importantly, was bolstered notably by the development of the tertiary, construction and industrial production sectors. This indicates that progress is being made towards diversifying the economy. Prices have continued to behave very moderately. On balance, the structural reform agenda has been well on track. Social indicators have improved further —although the authorities are conscious that the results are still very modest. And the sound fiscal and monetary policies that have made possible the cited economic performance have also been key to promoting foreign confidence in the economy, as evidenced by the upsurge of capital inflows and by the positive conclusion of agreements with most Paris Club creditors —the latter making it possible for the authorities to achieve a lower current account deficit that projected in the program.

To consolidate these economic gains and strengthen further the process of placing the economy in a sustainable path of growth, the authorities have committed themselves to the implementation of a program whose objectives I consider ambitious but attainable—provided that episodes of social unrest like the ones experienced in June 1998 do not proliferate, with undesirable consequences for the implementation of the program. In this respect, I would like to ask the staff if there has been any other social incidents, and how it regards the authorities' attitude towards reducing the risks that this type of events could jeopardize the country's sound economic performance in the period leading up to the presidential elections.

Turning to the details of the program and, more precisely, to the fiscal area, I welcome the authorities' decision to forge ahead in the process of fiscal consolidation. The efforts to enhance revenue collection and control expenditure—while giving due consideration to the need to increase allocations to health, education and capital spending—will make it possible to continue broadening public savings. However, with respect to revenue collection, more determination ought to be dedicated to improving a still weak tax accrual. In this respect, the six month delay in adopting the value added tax reform is evidence, first, that there is room to be more ambitious and, second, that more determination will be necessary, notably when taking into account the need to offset the loss of revenue stemming from trade liberalization. On the expenditure side, I would like to emphasize the importance of containing the growth of current expenditure, the phasing out of subsidies and the safeguarding of capital spending.

I welcome the authorities' determination to support the prudent monetary policy of the Central Bank of West African States while seeking to develop instruments of indirect monetary management. In addition, I would like to commend the authorities for their fruitful efforts to enhance the soundness of the banking system.

Finally, with respect to the essential structural reform agenda, I welcome the measures that will be taken to make headway towards: a) the completion of the privatization and restructuring process; b) the reform of the agricultural, water, transport and energy sectors; c) the direct steps that will be taken to improve the participation of the private sector in economic activity; d) the implementation of the program on good governance whose importance I would like to emphasize; and last, but not least, the social program that will be undertaken to reduce poverty and improve education and health.

With these remarks, I wish the Senegalese authorities the best in their endeavors.

Mr. Shojaeddini made the following statement:

Senegal has made significant progress since 1995 by undertaking a broad economic adjustment program supported by ESAF arrangements. The authorities have successfully implemented the macroeconomic and structural reform program under the first year of a new ESAF arrangement, while observing all performance criteria and benchmarks. The economy continued to perform well in 1998: real GDP growth strengthened, inflation remained subdued, and the external current account deficit declined. Looking forward, the economic prospects for 1999 also remain good, and the inflation rate is expected to remain within its medium term target. GDP growth is projected to perform better than the medium term target level, reflecting a rebound in agricultural activity after two years of decline, and higher growth in other areas of the primary sector. The external current account deficit is expected to be only slightly higher than in 1998. We concur with the authorities' medium term adjustment strategy and support the second annual arrangement.

Given the pegged exchange rate regime, fiscal and structural policies are at the heart of the Senegalese adjustment program. We welcome the fiscal measures implemented in 1998 and those envisaged for 1999, as elaborated by Mr. Barro Chambrier in his comprehensive statement. We note with satisfaction the progress being made in fiscal consolidation and in strengthening customs and tax administration. The high priority accorded to the social sector in raising its share in total expenditure is also encouraging.

However, it is important to increase the efficiency of these expenditures. In view of the relatively poor social indicators, the social program outlined in the policy framework paper should be pursued vigorously. In the structural policy reform area, the authorities should be commended for undertaking important adjustment efforts, and adopting an ambitious agenda of structural and sectoral reforms for the future. They have already identified the impediments to private sector led growth and poverty reduction objectives, and are addressing them accordingly.

Although important progress is being made in privatization, sector reform, and the development of a favorable environment for private sector activity, we agree with the staff that more needs to be done in these areas. In particular, greater efforts in promoting good governance can be very effective in restoring private sector confidence. On public sector activity, could the staff comment on the preliminary findings of the first phase of the consumer survey on the quality of public services? What needs to be done in the future on the basis of these findings?

With these remarks, we wish the authorities continued success in implementing their adjustment and reform programs.

Mr. Mafararikwa made the following statement:

I would also like to register our support for the authorities' request for continued Fund financial assistance, while acknowledging their strong track record of policy implementation. We welcome the intention to accelerate the privatization program. The restructuring of 13 public enterprises will, however, require a lot of technical and administrative effort, and we fear that the program is rather too ambitious.

On the issue of external debt, it is encouraging that some of the benefits derived from debt rescheduling are already translating into increased social spending and poverty reduction. We hope that the intention to reduce the domestic debt will release more resources for these sectors. In this respect, like Mr. Barro Chambrier, we hope that the possible enhancement of the HIPC Initiative will benefit Senegal.

The delay in the introduction of the value added tax is understandable. Developments in Ghana and Uganda are typical examples of what can happen if a value added tax is introduced without adequate preparation. Furthermore, the introduction of a value added tax during an election year may not be good timing, particularly if preparation is inadequate.

The staff representative from the African Department noted that most of the non-Paris Club bilateral creditors—including the Arab Monetary Fund—had been approached by the Senegalese government with a view to concluding bilateral debt rescheduling agreements consistent with the debt-stock-reduction terms granted to Senegal the preceding year. In 1998, the authorities had paid off all extrabudgetary arrears, and there was at present no indication that extrabudgetary arrears for 1999 would arise.

The drawdown of deposits, which had accumulated during 1999, reflected the authorities' decision to issue a supplementary budget for 2000, as they had done in the previous two or three years, the staff representative said. According to that budget, part of the privatization proceeds would be used for social investments in the rural sector, including the digging of wells and the building of new hospitals.

With respect to private sector activities, the World Bank had recently concluded a study that identified obstacles to investment in Senegal, the staff representative related. The government was currently studying the findings of that report with a view to designing an action plan that would address administrative and other obstacles. The expectation was that, between July and October 1999, the authorities would present an action plan—on which the Bank and the Fund would comment—to be implemented by the end of the year.

The supplementary budget included an additional appropriation for social spending, the staff representative continued. Over the past few years, Senegal had experienced a one-to two-year lag in the spending of those appropriations; in other words, social spending in 1999 likely constituted the appropriations that had been made in 1997 and 1998. The Bank and the Fund had asked the authorities to conduct a study to identify the factors behind the lag, and make recommendations on how to address them.

There had been some labor disrupting recently, which had disturbed the social climate, but the government was currently negotiating with the labor unions, the staff representative informed. There had already been a wage settlement in the private sector, and the authorities were currently reviewing the tax law applicable to wages in the public sector, with a view to granting relief to government employees rather than agreeing to actual wage increases for 1999.

With respect to the sensitive issue of reforming the value-added tax, the authorities were planning to merge the two existing rates of 10 and 20 percent into a single rate of about 18 percent, the staff representative explained. That would have the effect of increasing the costs of certain consumer items—including basic commodities—that could adversely affect the social climate in Senegal, if the reform was not carefully prepared and explained before its introduction. The government needed a six-month period to prepare the population for the change. The staff would review the issue of value-added tax reform at the time of the midterm review, which was scheduled to take place in the fall of 1999, in order to make sure that the proposed delay would not generate an excessive loss of revenue beyond the loss of 0.4 percent of GDP currently projected. If a shortfall still appeared likely after the compensatory measures had been implemented, the World Bank would stand ready to cover any financing gap that might arise as a result of the transition costs of the reform.

The consumer survey that had recently been carried out stated, among its preliminary findings, that the civil service lacked responsiveness vis-à-vis the population, and that there was a need to bring it closer to the population through decentralization and improved governance, the staff representative concluded. The next stage of that reform would take place before the end of the year, and a national conference, with the participation of all parties involved, would discuss how best to improve the relationship between the population and the civil servants.

Mr. Barro Chambrier noted that his authorities were faced with several important challenges, which included meeting the social needs of the population, removing bottlenecks in order to strengthen fiscal performance, speeding up the pace of structural reforms, and strengthening budget management. On the latter issue, Senegal compared relatively well with other countries in the region, although the quality of social allocations must be improved, and exemptions to the tariff regime— "the precisions tarifaires"—must be removed. The authorities had committed themselves to eliminating those by the end of the year, although that was no easy task given the social climate in the country. The planned reform of the value-added tax was also a complex undertaking. The authorities were preparing the ground and the sequencing of the program in order to minimize potential social disruptions, especially in view of the upcoming elections.

He would convey the Board's views on the need to carefully monitor expenditure in the period leading up to the elections, keep up the momentum on structural reform, improve governance, and allow for improved allocations in the social sector, Mr. Barro Chambrier concluded.

The Executive Board took the following decision:

1. Senegal has requested that the second annual arrangement, in an amount equivalent to SDR 35.67 million, under the three-year arrangement for Senegal under the Enhanced Structural Adjustment Facility (EBS/98/68, Sup. 1) be approved.

2. The Fund notes the updated policy framework paper for Senegal set forth in EBD/99/78.

3. The Fund approves the second annual arrangement set forth in EBS/99/114.

Decision No. 12010-(99/76), adopted
July 12, 1999

2. LESOTHO—1999 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1999 Article IV consultation with Lesotho (SM/99/148, 7/25/99). They also had before them a paper on recent economic developments and selected issues in Lesotho (SM/99/153, 6/30/99).

Mr. Morais made the following statement:

As acknowledged by staff in their report to the Board, Lesotho enjoyed a period of buoyant economic conditions in the years up to 1996/97. Reflecting a prudent approach towards economic management, this period saw a noticeable improvement in the underlying economic fundamentals as inflation was reduced to single-digit levels and foreign reserves were accumulated to a comfortable level. Equally important though, the Lesotho authorities utilized this growing prosperity to effect notable improvements in social conditions, as reflected in a significant decline in infant mortality, and increases in life expectancy and adult literacy.

Economic conditions, however, became increasingly more difficult in the subsequent two years as economic activity in South Africa slowed down on account of the turbulence in global financial markets, activity related to the Lesotho Highlands Water Project (LHWP) declined, and as civil conditions in Lesotho became unsettled on account of the actions of the Lesotho Defense Force. Reflecting structural factors, the overall budget deficit, excluding grants, rose from 1.5 percent of GNP in 1997/98 to an estimated 4.2 percent in 1998/99. This rise in the deficit should, however, be evaluated against the background of a decline in customs revenue and significant increases in bank restructuring costs (3.1 percent of GNP) and interest payments (0.7 percent of GNP). Mostly reflecting the impact of external developments, the overall balance of payments position also deteriorated during the year. However, despite this, reserve coverage still increased moderately to 9.0 months of imports.

Against a background of some significant changes in the external environment, most notably the estimated decline in activity related to the LHWP and the anticipated regional trade reforms, my Lesotho authorities have decided to launch an ambitious program of economic reforms over the medium term in order to ensure a continued strong performance of the economy. The major elements of this program entail the continued implementation of prudent macroeconomic policies to safeguard economic stability, and wide-ranging structural reforms to improve the efficiency of the economy and increase Lesotho's attractiveness to foreign investment. During his recent visit to the Fund, the Minister of Finance presented the government's policy matrix to the staff, and took great care to confirm the government's commitment to those policy measures that will ensure a sustainable rise in economic performance. At the same time, the Minister conveyed to Fund management the government's request that implementation of the economic program be supported by appropriate assistance from the Fund. I would urge that negotiations with staff and management in this regard be brought to a timely conclusion.

A central element of the government's efforts to ensure the continuation of the past performance of high growth will be supporting financial policies to preserve macroeconomic stability. However, after a number of years of strongly accumulating precautionary deposits, the environment for implementing fiscal policy has become more difficult as the ongoing regional trade reforms, including the reform of the formula for determining revenue from the South African Customs Union, will have a substantial negative impact on public revenue. In addition, the need to rebuild the economy following the unrest of 1998 has necessitated an increase in the budget deficit (excluding grants) to a budgeted 7.4 percent of GNP in 1999/00. However, my authorities have committed themselves to a fiscal deficit that will be consistent with the continued accumulation of government deposits with the banking system. To this end, measures will be implemented on both the revenue and expenditure side of the budget.

In the area of revenue, this will entail the planned introduction of a value-added tax at a uniform rate in April 2000, as well as a number of initiatives to strengthen domestic revenue capacity. Regarding the latter, increased efforts will be addressed at the training of personnel in the revenue departments, completing the computerization of all revenue departments, and extending the taxpayer identification system to sales tax, income tax and the customs departments. In addition, the Lesotho government is negotiating with the South African Revenue Services to assist them with the collection of the sales tax/VAT at the border post. In the area of expenditure, my authorities plan to reduce the ratio of expenditure to GNP from a budgeted 44.1 percent in 1999/00 to 36.5 percent by fiscal 2002/03. To this end, the public wage bill will be reduced from a budgeted 13.9 percent in 1999/00 to 11 percent in 2002/03 through a restructuring and right sizing of the public service, development of a job grading and evaluation system, and decompression of pay scales. In addition to these measures, my authorities have confirmed their readiness to implement additional measures that may be required to achieve their stated objectives in this area.

Monetary policy will continue to be anchored by the peg of the loti to the South African currency. Measures will also be introduced during 1999/00 to enhance indirect instruments of monetary control. Studies have already been completed and a Blue Print have been finalized on the development of a Treasury Bill Auction System. In addition, substantial progress has been made with the restructuring of the banking sector. As noted by staff, my authorities have enacted the Financial Institutions Act which provides the framework for strengthening the prudential regulation of banks in line with the Basle Accord. Furthermore, a bill has been passed by parliament and a liquidator appointed to complete the liquidation of the Lesotho Agricultural Development Bank (LADB), while a management contract have been awarded to Standard Bank

(Lesotho) to complete the recapitalization and restructuring of the Lesotho Bank.

The main focus of Lesotho's external policy is to ensure a trade system that enhances external competitiveness, and that will be conducive to foreign investment. In this regard, every effort will be made to maintain flexible labor market conditions and, over the medium term, to enact an Investment Law in order to remove all remaining administrative barriers to foreign investment. In addition, special measures will be implemented to promote the development of micro, small and medium-sized enterprises, while corporate income tax rates will be lowered to maintain Lesotho's competitiveness in the region.

Mr. Ondo Mañe made the following statement:

After several years of robust economic growth and marked progress in essential social areas Lesotho's economy is now experiencing a severe reversal with no clear idea on how long it will last. During the period of strong growth, Lesotho's economic performance benefited from favorable external developments with the boost coming from the proximity of its giant neighbor with which it shares, together with other countries, the Common Monetary Area (CMA) and the membership of the Southern African Customs Union (SACU). The major difficulties that have been facing Lesotho since the past year stem mainly from its lack of capacity to adapt after the completion of the Lesotho Highlands Water Project (LHWP), the shrinking of receipts from the SACU and far-reaching changes in migrants policy in the neighboring countries. Among those countries, South Africa, the largest, enacted new laws that reduced substantially remittances to Lesotho. Finally, Lesotho was not able to seize the opportunity of its robust economic growth during the lucky period of the past decade to pay due attention to the importance of the structural reforms necessary to help the economy keep moving strongly.

It is, therefore, clear that efforts aiming at reversing the economic downturn should seek to address forcefully these weaknesses. In this connection, I welcome the authorities decision to embark on a program of economic reforms with a view to addressing the difficult economic situation and I agree with the staff that Lesotho needs a comprehensive macroeconomic and structural reform program as indicated in the Box 4, susceptible to help adapt policy response to some fundamental changes in its neighboring countries. To this end, it is encouraging to learn from Mr. Morais' helpful buff statement that the authorities reaffirmed the government's commitment to the policy measures contained in the program.

On the fiscal issues, the transfers from the SACU that, so far, have provided substantial resources to the budget and the balance of payment, are expected to decline sharply during the medium term on account of changes in factors that determine the revenue share of members of the Union. This adverse situation is expected to be compounded by both the trade liberalization process in the region and the downsizing in the activities related to the LHWP program. Furthermore, the landlocked nature of Lesotho and the common external tariff rule may not make it easy for the country to find a new way to boost its revenue. In this context, the authorities' decision to expand the tax base and to introduce a VAT is the right way to raise revenue and to build an effective domestic revenue capacity. While I agree with all accompaniment actions ranging from the removal of excessive political involvement in tax administration to enhanced training of staff as the right measures to achieve the objectives, I am, however, of the view that these measures, to be effective, should be front-loaded and start to be implemented without delay.

So should be the measures to rationalize expenditure which need to be prioritized, in line with the agreement reached with the World Bank in the context of the Public Expenditure and Budget Management Review. Important financial repayments are scheduled for the near future, and Lesotho should begin to put in place incentives to retain in the country its well-educated and skilled personnel in order to address the important challenges facing the authorities. The conservative approach in the budget management could not continue to prevail since it might have adverse bearing on anticipated outcomes. In that vein, the budgets of parastatals should be incorporated in the government budgeting system, keeping in mind that the government has guaranteed most of the debts of these enterprises. I also welcome the set of measures presented by the staff to change dramatically the budgeting system approach in order to allow the budget to expand on more than one year with a view to both easing the budget management and reducing substantially expenditure to levels compatible with available resources. I encourage the authorities to enact their intention to review the 1999/2000 budget in order to avert unsustainable fiscal gap during the course of the year.

In the monetary and banking sector the authorities have made commendable efforts to rationalize the banking system by enacting regulations aimed at setting a sound prudential framework. But what is important is to keep in close watch the developments in the neighboring countries of the monetary and financial area, so as to adapt regularly when needed.

In the external sector, the contraction in external current account deficit despite the increase in the overall fiscal deficit does not mean a looming end of financial disturbance. Rather, balance of payment projections are on the pessimist side. The completion phase of the LHWP along with reduction in the related investment explains mainly the slowdown in the current account deficit. Here again, in order to recover from this downturn, Lesotho will count on domestic far-reaching structural changes, mainly in strengthening its industrial sector, creating new job opportunities in the country to retain its workers, improving their skill through training programs, and reconverting the migrants workers towards new activities. In that vein, I commend the authorities for the priority given to education in their drive to enhance the human capital as it is essential to attract foreign businesses. However, more needs to be done, particularly with respect to attracting foreign direct investment. For this to happen, it is crucial that the political situation improves significantly.

In conclusion, the lesson one can draw from the Lesotho's case is that the best assessment of the soundness of an economy should not be limited to the high output growth and the low inflation rates, or the importance of capital inflows and the amount of the foreign direct investments. What should also be taken into consideration is the sustainability of the economy in the medium and long terms. During a decade Lesotho enjoyed a robust economic development but missed to strengthen the economy through essential reforms. The macroeconomic stabilization and structural reform program of the new strategy adopted by the authorities, if implemented appropriately could make the difference in Lesotho. However, due to the number of deep-seated weaknesses, it is crucial that the authorities show more willingness for changes in line with developments in the region. Furthermore, they may need a strong support from the Fund's technical assistance to ensure sustainable reforms aiming at achieving their goals.

Mr. Luo made the following statement:

At the outset, I would like to thank the staff for the comprehensive papers and Mr. Morais for his very helpful statement. While I could generally agree with the staff appraisal, I would like to make a few comments for emphasis.

Having enjoyed a decade of strong economic growth, a sharp reversal in Lesotho's economic situation has taken place in the past two years, due mainly to some uncontrollable external factors and a decline in activity related to the Lesotho Highlands Water Project. Against this backdrop, I am encouraged that the authorities have decided to start an economic reform program to reverse the downturn in the situation and rejuvenate the economy. I am also glad to learn from Mr. Morais's statement that the authorities have reaffirmed their commitment to the program's policy measures. I have noted that in the banking sector reform field, substantial progress has been achieved, showing the authorities' firm determination for further reforms. In this context, I would like to support the authorities' urgent request that implementation of the economic program be supported by appropriate assistance from the Fund. Like Mr. Morais, I also hope that the authorities' negotiations with staff and management in this regard will soon bear positive results.

How to make the economic growth more sustainable? It is really a very complicated issue. The consistent economic reforms, although not a panacea, could play a crucial role. In this regard, I could see the merits in Mr. Mañe's comments expressed in his thoughtful gray.

With this remarks, I wish the authorities every success in their future reform endeavors.

Mr. Morais made the following concluding remarks:

I would like to thank Mr. Luo and Mr. Ondo Mañe for their comments and the other Directors for their interest in Lesotho. I will convey faithfully the comments expressed and the recommendations of the staff to my Lesotho authorities.

The authorities are fully aware of the need to implement a sound macroeconomic policy framework. They have requested Fund support for the recently adopted policy matrix. In this regard, the authorities used the prosperity of the past decade to implement notable changes in social conditions. During this period, the authorities continued to pursue sound financial policies enabling them to now focus on the required structural changes to ensure the continued strong performance of the Lesotho economy.

The Acting Chairman made the following summing up:

Executive Directors, taking note of the statements made by Mr. Morais, Mr. Ondo Mañe, and Mr. Luo, broadly agreed with the thrust of the staff appraisal in the report for the 1999 Article IV consultation with Lesotho.

It is expected that the next Article IV consultation with Lesotho will be held on the standard 12-month cycle.

3. ALASSANE D. OUATTARA—RESOLUTION OF APPRECIATION

The Executive Directors unanimously adopted a Resolution of Appreciation to Mr. Alassane D. Ouattara on the completion of his service as Deputy Managing Director.

"WHEREAS on July 31, 1999, Mr. Alassane D. Ouattara will relinquish the post of Deputy Managing Director which he has held since July 1, 1994, after having served as a staff member from 1968 to 1973 and from 1984 to 1988, thus completing a record of distinguished service in the Fund; and

WHEREAS Mr. Ouattara, with his vast experience inside and outside the Fund, brought an invaluable dimension to our work here; and

WHEREAS Mr. Ouattara, throughout his career at the Fund, has devoted himself wholeheartedly to the service of the institution and made a lasting contribution to the Fund's efforts to help members address challenges and benefit from opportunities in an era of globalizing financial markets; and

WHEREAS Mr. Ouattara has brought with him the highest qualities of public service, marked by absolute rectitude and public spiritedness, and unequaled courtesy and generosity, which he extended to all of us; and

WHEREAS Mr. Ouattara has been valued as friend and counselor by Executive Directors and staff members alike;

NOW THEREFORE IT IS RESOLVED: That the members of the Executive Board express unanimously to Mr. Ouattara their tribute to his committed service to the Fund; their appreciation for his outstanding achievements during his period of service; their hope that they may continue to count on his friendship; and their best wishes for satisfaction and fulfillment in his future activities."

Adopted July 12, 1999

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/99/75 (7/9/99) and EBM/99/76 (7/12/99).

4. AUDIT REPORT, 1999—TRANSMITTAL TO BOARD OF GOVERNORS

The Executive Board approves the draft Letter of Transmittal to the Board of Governors from the Managing Director, on behalf of the Executive Board. (EBAP/99/81, 7/6/99)

Adopted July 9, 1999

5. RELEASE OF INFORMATION TO FINANCIAL STABILITY FORUM—BOARD PAPERS ON ARCHITECTURE

The Executive Board approves the release of the staff papers on architecture to the Financial Stability Forum as set out in EBD/99/79 (7/6/99).

Adopted July 9, 1999

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, Advisors to Executive Directors, and Assistants to Executive Directors as set forth in EBAM/99/99 (7/8/99) is approved.

APPROVAL: June 5, 2000

SHAILENDRA J. ANJARIA
Secretary