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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/2

2:30 p.m., January 13, 1997

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

A. D. Ouattara, Acting Chairman

Executive Directors	Alternate Executive Directors
	J.G. Borpujari, Temporary
	O. Himani, Temporary
M.-A. Autheman	A. Fayolle
	C.X. O'Loghlin
	T. Turner-Huggins, Temporary
	A. Guennewich, Temporary
	R.J. Heinbuecher, Temporary
	K.S. Brownlee, Temporary
	A. Giustiniani, Temporary
	J.M. Jones, Temporary
	J.A.K. Munthali, Temporary
D. Kaeser	U.Y. Tilyayev, Temporary
	G.P. Ramdas, Temporary
	A. Cserés, Temporary
	D.G. Loevinger, Temporary
	M.W. Ryan, Temporary
	S. Fukushima, Temporary
	M.-H. Mahdavian, Temporary
	E. Kouprianova, Temporary
	W.F. Abdelati, Temporary
	R. Kannan, Temporary
	D. Giga, Temporary
	M.B. Alemán, Temporary
	M.A. Cilento, Temporary
	P.I. Botoucharov, Temporary
K. Yao	A. Barro Chambrier
	S. Joyosumarto
	O. Sein, Temporary
	He J., Temporary
	D. Merino, Temporary

W.S. Tseng, Acting Secretary
G.N. Walton, Assistant

Also Present

IBRD: P.N. Kervyn de Lettenhove, Western Africa Regional Office; M. Dia and P.C. Harrold, Africa Technical Office; B. Ngo, Economic Development Institute. African Department: E.A. Calamitsis, Director; G.E. Gondwe, Deputy Director; P.A. Acquah, D.T.S. Ballali, G. Devaux, J.E.J. De Vrijer, I.A.H. Diogo, M. El Qorchi, J. Fajgenbaum, M. Fouad, C.A. François, D. Ghura, M. Katz, M.W. Lewis, J. Ntamatungiro, J.T. Reitmaier, K.-W. Riechel, P. Rother, J. G. Scarlata, N. Toé, E.J.G. Verreydt. European I Department: O. Dore. External Relations Department: M.E. Hansen, K. White. Legal Department: P. De Boeck, J. M. Ogoola. Policy Development and Review Department: R.J. Bhatia, T. Nishizawa, C. Puckahtikom. Secretary's Department: K.S. Friedman, P. Gotur. Treasurer's Department: C. A. Hatch. Office of the Managing Director: J.A.P. Clément. Advisors to Executive Directors: G.M. Iradian, A.R. Ismael, B. Konan, S. N'guiamba, J.-C. Obame, V.Y. Verjbitski. Assistants to Executive Directors: M.A. Brooke, A.L. Coronel, L. Fontaine, J. Hamilius, J.K. Honeyfield, H. Javaheri, K. Kpetigo, T.-M. Kudiwu, I. Moon, L. Pinzani, E.T. Rădulescu, E.L. Zamalloa.

1. REPORT BY MANAGING DIRECTOR

The Managing Director said that he had visited Romania over the period December 20-21, 1996 to become acquainted with the new leaders that had taken office in early December after winning the elections in November. Meetings were held with President Constantinescu, the President of the Chamber of Deputies, the President of the Senate, the Prime Minister, several cabinet Ministers, former President Iliescu, foreign ambassadors, the Patriarch of the Orthodox Church, a number of labor unions leaders, representatives from a large number of nongovernmental organizations, and the resident representatives of other international financial institutions. The former President Iliescu and other members of the PDSR were praised for the manner in which power had changed hands. They were urged to take on a constructive role as the main opposition party, emphasizing that a comprehensive reform of the economy would be key to Romania's aspirations to achieve early membership of the EU and NATO.

The new government was clearly surprised by the severity of the economic situation that it had inherited, the Managing Director remarked. A major relaxation of policies in the run-up to the November elections had caused the fiscal deficit and inflation to increase to more than twice the programmed level. A serious lack of foreign exchange was now causing energy shortages that could severely disrupt output in the coming months.

The severity of the immediate stabilization problems had placed the government in a difficult situation as it would be unable to fulfill a number of important and costly campaign promises, the Managing Director continued. Solving those problems would be an early test of the cohesiveness of a coalition that represented quite diverse constituencies. The government had, however, already begun the process of cooling public expectations about early fulfillment of election promises. For example, it had made public the findings of the staff team that was in Bucharest in early December to assist the authorities in diagnosing the problems.

The new government had campaigned on the basis of a major acceleration of structural reform, and it was pleasing to discover that the authorities were serious in that regard, the Managing Director stated. The opportunity was taken to remind the authorities that previous Fund-supported programs with Romania had been short-lived because the macroeconomic targets had soon given way to demands for agricultural credits, and for an overvalued exchange rate in order to maintain low energy prices. Any new program would not be sustainable without ambitious reform aimed at containing the deficits in the agricultural sector and in energy-intensive enterprises. The government shared those views and hoped to reach an agreement with the World Bank on an Agriculture Sector Adjustment Loan and a Financial and Enterprise Sector Adjustment Loan by early spring.

The government and the Fund were concerned about the adequacy of resources for social programs, the Managing Director said. The large subsidies that had been channeled to ailing enterprises in recent years had taken place at the expense of resources for social programs. A new program would clearly need to allow for incremental allocations for social programs, especially child allowances. Most government officials, and representatives of the nongovernmental organizations, confirmed that the plight of children continued to be an issue of particular concern in Romania. However, there had been a push for a significant increase in military expenditures based on the claim that a major modernization of the armed forces would be a condition for early membership of NATO. It was emphasized that increases in military expenditure should be resisted as much as possible in light of social spending needs.

Recent developments had proved that the democratic institutions in Romania were functioning well, the Managing Director stated. The prospect of early membership of EU and NATO was also clearly having a positive influence on all major parties in Romania. One example of that influence was the broad-based support received the previous summer, in the midst of a hard-fought election campaign, for an agreement clarifying relations with Hungary.

Meetings with leaders of labor unions and nongovernmental organizations showed that there was a clear realization that a substantial acceleration of reform was needed to fulfill expectations about an early increase in living standards, the Managing Director added. Those representatives were fully aware that the early phase of the reform process would involve unavoidable social costs. They emphasized the need for adequate resources for social programs and for transparency in economic policies.

The visit to Bucharest had confirmed the firmness of the government's commitment to abandon the hesitant and piecemeal approach to reform that had characterized Romania in the recent past. The Fund stood ready to support the authorities' efforts, and a mission would visit Romania in mid-January to begin discussions on a program that could be supported by a Stand-By Arrangement.

At the invitation of the authorities, a visit was made to Jordan over the period January 7-8, 1997, the Managing Director continued. Meetings were held with His Majesty King Hussein, the Minister of Finance, the Governor of the central bank, the economic team headed by the Acting Prime Minister, the Presidents of the Senate and of the Parliament, the Chairmen of the various finance committees, business leaders, and members of the press.

Jordan had undergone a remarkable adjustment in the 1990s, the Managing Director said. At the beginning of the period, the fiscal deficit (excluding grants) was 18 percent of GDP, inflation 10 percent per annum, the external current account deficit (including grants) 19 percent of GDP, and the level of debt unsustainable. By 1996, the fiscal deficit (including grants) had been reduced to 4.6 percent of GDP, monetary policy had been tightened and interest rates were positive in real terms, the external current account had been reduced to 3 percent of GDP, the overall level of external debt in terms of GDP had been halved to below 100 percent, and underlying inflation was about 4 percent per annum. Average annual growth in the previous three years had been close to 7 percent. By international standards, that performance was remarkable, all the more so as it was achieved in a difficult external environment in terms of the fallout from the Gulf war, cuts in external assistance, and uncertain political developments in the region.

The authorities had reiterated their commitment to strengthening the adjustment effort, in particular through fiscal consolidation in the period ahead, and to accelerating structural reforms in such areas as trade liberalization, tax reform, and private sector encouragement, the Managing Director stated. There was a cultural change taking place in Jordan where most segments of the population now clearly endorsed the need for fiscal discipline, contraction of the role of the state in order to make room for the private sector, and trade liberalization. It was clearly recognized that public sector employment (35 percent of total employment) and public expenditure as a whole (one-third of GDP) had to be scaled down. Moreover, the association agreement with the European Union and membership in the World Trade Organization, which were being actively sought by the government, were seen as essential to improve the dynamism and productivity of the economy in contrast with previously inward looking policies. Quite notable also was the fact that all parties welcomed the close relationship established with the Fund over the years.

Notwithstanding the strong performance in terms of growth, inflation, and external accounts, there were two prominent adverse developments, the Managing Director said. First, unemployment, although having declined from 20 percent in the early 1990s, was still high at about 15 percent. Second, the level of poverty, almost nonexistent in the mid-1980s, had now increased to 20 percent of the population. And per capita income was lower than in the second half of the 1980s. It was mainly for those reasons that many segments of the population failed to recognize the large positive gains achieved in recent years.

As for the peace process, King Hussein firmly maintained that it was irreversible, the Managing Director said. But other interlocutors argued that the process was stalled, claiming that Jordanians felt "cheated" because the promises of substantial financial assistance made to Jordan by major donors had not materialized. It was repeatedly mentioned that, given the uncertain political progress in the West Bank and Gaza, there was at present a gradual redemption of Jordan dinars. In that regard, the authorities emphasized that Jordan would not be able to cope with a massive and sudden redemption given the low level of its reserves.

Two issues were essential for coping with the current economic issues, the Managing Director emphasized. They were the alleviation of poverty and increasing the role of the private sector. The authorities were committed to maintaining sound macroeconomic policies, speeding up the privatization process, creating the proper climate for strong private investment, both by Jordanians and foreigners, and designing a genuine program for the poor. Actions were in fact being taken on all these fronts. The Prime Minister was chairing a committee to design an accelerated privatization program, and new legislation was before Parliament that would improve the climate for private investment. On the poverty issue, the government, with the assistance of the World Bank, was designing a plan aimed at better targeting of subsidies, steering infrastructure to the poorest regions, training, and financial assistance to micro enterprises.

The authorities requested an increase in access under the exceptional circumstances clause, the Managing Director reported. It was explained that management was prepared to recommend an increase in access to a cumulative 300 percent of quota, placing Jordan among the two or three countries with such a high access. That should be seen as proof of the confidence the Fund placed in the economic management by the authorities. The staff report, to be issued in the coming days on the second review of the Extended Arrangement, would put forth that issue for consideration by Executive Directors.

2. REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director, Mr. Ouattara, reported that he had visited Cameroon and Gabon during the period January 5-9, 1997. In Cameroon, meetings were held with President Biya, members of the government, and representatives of the international community, the private sector, labor unions, and the press. Emphasis was placed on the continuation of Cameroon's efforts to enhance credibility in policy implementation, including transparency in the management of public resources. The authorities realized that it was critical to address the country's economic and financial difficulties in a medium-term framework, possibly with a program supported by the Enhanced Structural Adjustment

Facility (ESAF). That would help in laying the groundwork for normalizing relations with the international community.

In concluding the 1996 Article IV consultation with Cameroon, Executive Directors had underscored the importance of full and sustained adherence to the staff-monitored program for 1996-97, the Deputy Managing Director said. A staff mission that visited Yaoundé during December 6-19 had found that, while encouraging progress had been made regarding structural reforms, there were slippages in the fiscal area, owing in part to shortfalls in oil revenue. The mission identified a number of measures needed to bring the program back on track by end-January, including the transfer of surplus oil revenue from the national hydrocarbons company to the budget.

The President was fully aware of the details of the implementation of the staff-monitored program, the Deputy Managing Director continued. In that regard, he was committed to accelerating the civil service reform, financial sector restructuring, and the privatization of public enterprises.

A major hurdle that needed to be overcome was the repayment of nonreschedulable external arrears, which amounted to some CFAF 200 billion at the end of November, the Deputy Managing Director remarked. Those arrears were equivalent to about $400 million, or one quarter of government revenue. The President agreed that windfall gains from the petroleum activities carried out by the hydrocarbons company would need to be transferred to the budget in order to meet some of those payments.

Overall, the new government that took office in September 1996 appeared determined to break with previous stop-go policies, and was taking bold measures to address the situation, the Deputy Managing Director said. Representatives of the international community and the private sector viewed the change positively, but felt that more should be done to muster domestic support. A Fund mission was scheduled to visit Cameroon in the next few weeks to begin negotiations on an ESAF-supported program.

During meetings with officials of the central bank, it was agreed that there was a compelling need to strengthen the financial system, particularly bank supervision, the Deputy Managing Director remarked.

In Gabon, meetings were held with President Bongo, members of the government, and representatives of the private sector. While commending the Gabonese authorities for the progress made under the Extended Arrangement, the importance of strict program implementation was stressed, particularly in the structural area. The authorities indicated that the program seemed to be on track. A Fund mission would visit Gabon in the near future to ascertain recent economic developments and performance.

President Bongo agreed in principle to Gabon's contribution to the financing of the continuation of ESAF operations, the Deputy Managing Director added.

In both Cameroon and Gabon, the authorities were urged to strengthen their adjustment efforts to preserve the gains in competitiveness in the aftermath of the CFA franc devaluation in January 1994. Given the economic significance of Gabon and Cameroon in the central African region, progress in those countries would be key to the success of the ongoing integration efforts.

Mr. Yao stated that his authorities welcomed the Deputy Managing Director's visit. They were thankful for his understanding of the main difficulties that they were confronted with, and were committed to the adjustment process.

3. SENEGAL—ENHANCED STRUCTURAL ADJUSTMENT FACILITY—THIRD ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on Senegal's request for the third annual arrangement under the Enhanced Structural Adjustment Facility (ESAF) (EBS/96/200, 12/24/96). They also had before them a policy framework paper for the period 1996–99 (EBD/96/164, 12/24/96).

The staff representative from the African Department made the following statement:

> Since the issuance of the staff report, the Senegalese authorities have provided information indicating that inflation, as measured by the average percentage change in the consumer price index for Dakar, declined from 8.1 percent in 1995 to 2.7 percent in 1996, slightly lower than envisaged. Based on preliminary but incomplete estimates for the last quarter of 1996, it appears that the fiscal targets of the program for 1996 were reached. government budgetary revenue, excluding privatization receipts, was in line with the program, and the wage bill was kept within the programmed ceiling.
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> The National Assembly adopted the 1997 government budget on December 13, 1996, consistent with the 1997 program. The law replacing the automatic promotion system in the civil service with a merit-based system was approved by the Council of Ministers on December 24, 1996, and is to be adopted jointly with the implementing decrees by the National Assembly by the end of January 1997.
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> The authorities have reported further progress in implementing the privatization program and energy sector reform. In mid-December, one-third of the capital of the national telecommunications company (SONATEL) was sold to a Swedish-American consortium for $140 million (CFAF 70 billion); a payment of $30 million (CFAF 15 billion) was made on December 31, 1996, and the balance will be paid in the first quarter of 1997. These proceeds will be applied, as intended, to reduce bank and nonbank liabilities of the government and to finance public investment projects. Calls for bids regarding the Société Sénégalaise des Phosphates de Thiès (SSPT) and the Société Propriétaire de l'Hôtel de l'Union Teranga (SPHU-Teranga) were officially launched on December 23, 1996. A bid was received for SONATRA-Air Senegal, but the authorities considered it to be inadequate. The law authorizing the privatization of the urban transportation company for Dakar (SOTRAC) is scheduled for adoption by the National Assembly by the end of January 1997.
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> The government adopted on December 14, 1996 a program of action for the reform of the energy sector, including the privatization of the national electricity company (SENELEC) and the abolition of the monopoly of the Société Africaine de Raffinage (SAR). Preparations for the implementation of these reforms are proceeding as planned, and a Senegalese delegation is

expected to visit the World Bank as of January 27, 1997 for discussions on the modalities of the reform.

The debt reduction operation of Senegal's commercial debt due to the London Club was closed on December 23, 1996, at an average price of 20 cents per dollar of eligible debt, with a creditor participation rate of 96 percent, including all the major creditor banks. The total cost of the operation is estimated at $15 million, including $2.8 million (CFAF 1.4 billion) to be borne by the Senegalese government.

Mr. Yao made the following statement:

Senegal has continued to make progress in the implementation of its structural adjustment program, under the second annual ESAF arrangement. Thus, since the inception of its medium-term adjustment program in early 1994, real GDP is estimated to have grown by 5.2 percent in 1996, against 2.0 percent in 1994; inflation, as measured by the consumer prices in Dakar, has been reduced to 3 percent from 32 percent in 1994 and progress has also been achieved in reducing the external current account deficit. The pursuit of strict fiscal discipline has helped to reduce the fiscal deficit, on a commitment basis and excluding grants, by more than half, to an estimated 1.9 percent of GDP in 1996, from 5.7 percent in 1994. Moreover, as envisaged under the programs, the Senegalese authorities have implemented far-reaching structural measures in the areas of price and market liberalization, labor market and regulatory reforms, the reform of the public enterprises and other sectoral reforms. The steadfast implementation of the policy measures has contributed to the improved economic performance and is laying the foundation for the development of a thriving private sector.

However, the achievement of the medium-term objectives of sustained economic growth and financial viability requires continued implementation of the reform measures to which the authorities remain fully committed. In that regard, they have prepared a program of adjustment for 1997 consistent with their medium-term strategy with the assistance of the Fund staff. The program aims at consolidating macroeconomic and financial stability through the pursuit of prudent demand management policies and at deepening structural reforms. In support of this program, the authorities are requesting Fund support under the third annual ESAF arrangement.

Fiscal consolidation will continue to remain the cornerstone of the program, where the objective is to reduce the fiscal deficit, on a commitment basis and excluding grants, to 1 percent of GDP. To this end, revenue is projected to increase to 15.5 percent of GDP in 1997. This improved performance will result from a higher level of economic activity as well as the full impact of the strengthened administrative capacity and the fiscal measures already implemented. Moreover, the authorities are also introducing a number of measures, which are fully described at paragraph 16 of their memorandum, at the Tax Department and Customs. These measures will further strengthen administrative capacity, widen the tax base and contribute to achieving the revenue objective. Furthermore, to prevent any shortfall in petroleum revenue and also with a view to liberalizing petroleum prices, a major review of the energy sector, with World Bank assistance, will be undertaken in the early part of 1997, with emphasis on the taxation of petroleum products and the mechanism for adjusting their retail prices.

As regards expenditure, the authorities will continue their efforts to curb nonpriority expenditure and ensure a better allocation of available resources. In this context, the policy of limiting the government wage bill and nonpriority spending while allowing for an increase in social outlays, mainly on health and education, will be pursued. Wage expenditure will be kept within the programmed limits, and no general wage increase will be granted in 1997; recruitment will be strictly limited to the number of separations to keep the level of civil service employees at their present level, except for the recruitment of teachers. The overall government wage bill is thus projected to amount to less than 6 percent of GDP. The social expenditure budget, as mentioned above, will show a small increase. Nevertheless, the authorities expect that the policy they are following will lead to a reduction in the share of current spending in GDP from 12.3 percent in 1996 to 11.5 percent in 1997. As regards the public investment budget, which the authorities have prepared with the assistance of the World Bank, it is projected to increase by 10 percent in 1997. This budget places increased emphasis on social infrastructure and agricultural development projects. The authorities are also taking steps to ensure a closer monitoring of the execution of the public investment program. Efforts to clear domestic arrears will continue in 1997 and a timetable for the clearing of the remaining arrears will be established, following the completion of the audits.

Monetary policy, which is conducted in the context of the West African Monetary Union, will aim at keeping the growth of domestic credit within limits consistent with the foreign assets and inflation objectives. The program thus envisages a growth of broad money of about 5 percent in 1997, and a reduction in the government's reliance on credit from the banking system which will allow for an expansion in the credit to the private sector. The authorities will also continue to work toward the modernization of the financial system, including improved prudential supervision and the creation of a regional stock market. Efforts to deepen financial intermediation and improve financing for private sector activities will be pursued.

In the structural area, significant progress has been achieved in the modernizing of the regulatory framework, the liberalization of prices and trade, as well as in the reform of the agricultural and public enterprise sectors. For 1997, the objective of the authorities is to build on the progress achieved. In this regard, the authorities intend to continue with reforms in the legal environment, as well as in the areas of transportation, energy, agriculture and the public enterprise sector. While they are aware that the structural reform program for 1997 is ambitious, my authorities are confident of its successful implementation.

As regards the external debt, while the debt sustainability analysis prepared by the staff indicates that the continued implementation of sound

> macroeconomic policies and prudent debt management will enable Senegal to maintain a sustainable medium- and long-term debt position, the fiscal weight of the debt will remain relatively important, and by the year 2000 the servicing of the external debt will continue to absorb as much as 26 percent of government revenue, thus, severely constraining the development efforts of the authorities. Under the circumstances, the authorities hope that through their adjustment efforts, Senegal will benefit from an appropriate reduction of its stock of bilateral debt with Paris Club members, in the very near future. Such an operation will enable Senegal to achieve a lasting solution to its debt problem. However, for 1997 the country will continue to rely on concessional assistance and debt relief to cover the financing gap.
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> In conclusion, I would like to state that my Senegalese authorities are very much encouraged by the results obtained so far under the ESAF. They would like to reiterate their continued strong commitment to the program's objectives and their determination to pursue the adjustment efforts. In this context, they stand ready to take all necessary measures to ensure the achievement of the objectives of the program, and are hopeful that they can continue to count on the assistance of the international community.

Extending his remarks, Mr. Yao said that his authorities were committed to the adjustment program. Budget revenues had exceeded the program target and expenditures had been kept within the program ceiling. In addition, the pace of implementation of structural measures had been accelerated in the context of the privatization program and the energy sector reform. His authorities were concerned however by a recent article in the newspaper *Le Monde* dated January 7, 1997 which seemed to convey an erroneous picture of recent economic developments in Senegal. For that reason, it was hoped that the Fund press release on Senegal, following the Board discussion, would reflect the strong economic performance achieved so far.

Ms. Turner-Huggins made the following statement:

> I wish to thank the staff for the useful and illustrative set of papers. Senegal has made some strong gains under the current ESAF and its economic performance and adherence to the program objectives in the last year deserve commendation. Senegal appears to now be reaping the benefits of the exchange-based adjustment of 1994 and encouraging signs abound: notable among which is that real incomes in the agricultural sector have improved by 40 percent since 1993 and export growth is buoyant. We applaud Senegal's observance of the performance criteria and structural benchmarks during the second year of the ESAF and welcome the reduction in the fiscal deficit to around 2 percent of GDP, the narrowing in external current account deficit since 1993, the lowering of inflation and the long awaited movement in privatization. We are encouraged by the very recent divestment of the one-third interest in the telecommunications company, SONATEL—and hope that this is catalytic to speeding up public enterprise reform . Despite these obvious successes, there is room for improvement: savings and investment ratios are still low in both the public and private sectors, poverty remains widespread, the adult illiteracy rate is way above the average for sub-Saharan Africa (despite a higher primary pupil to teacher ratio) and there remains

considerable government involvement in the economy—16 enterprises are still on the privatization agenda. This final year under the ESAF is pivotal in cementing the reform process under way—as the agenda remains packed with key institutional reforms necessary to the creation of an environment conducive to private sector development and a more efficient market driven economy. With the following additional comments, this chair is pleased to support the proposed decision for a third annual arrangement under the ESAF.

In the area of fiscal adjustment, on the revenue side, we welcome the attention placed on broadening the tax base. Given the need to expand government spending in the social sectors of health and education (noted by a 1 percent increase of total expenditures in 1997), the current level of the ratio of tax revenue/GDP remains woefully low. The aim to bring it up to 15 percent of GDP by 1998 seems not ambitious enough and I would be interested in the staff's position as to whether the tax reforms have gone far enough (for example is there need to address tax rates—as well as tax collections?). Specific and urgent attention should be placed on implementing the cost-pass through mechanism for the adjustment of petroleum prices as this item has been a drag on petroleum revenues. On the spending side, regarding the wage bill, we commend the Council of Ministers for their recent law replacing the automatic promotion system in the civil service with a merit-based system and urge the National Assembly to implement the necessary decrees by end-January as planned.

On structural reforms: in the area of privatization, we urge a pick up in the pace. In particular in the energy, transportation and agricultural sectors. We note the action plan adopted by the government in mid-December for the energy sector—and hope that the discussions with the World Bank later this month will have tangible and early results. It is disappointing for example, that the development policy for the energy sector will only be signed by March 1997 given that this policy covers measures included in the policy framework paper of October 1995. Staff views on the impact of privatization of SONOCOS on the unification of the informal and formal markets for groundnuts in Senegal would be helpful. Is there any explanation as to why in 1996, prices in the informal market were more favorable relative to the administered market? Might there be opportunity to expand exports of groundnuts if the two markets were merged?

On the financial system reforms, we would urge efforts to strengthen the financial system—both in terms of prudential norms and supervision as well as those geared toward financial deepening to aid in the mobilization of savings. In this vein, we welcome the efforts to reform the business law, and modernize the judicial system and encourage cooperation at the regional level on these issues. We note with concern the persistence of the wide spread on interest rates in commercial banks and would welcome staff's views on the costs of bank transactions in Senegal, the extent to which recovery of bad loans is an important element, and the degree of intermediation—we note the recent proliferation of credit unions (is this phenomenon unusual? Or is a similar expansion under way in banks?).

Finally, let me wish the Senegalese government every success in their endeavors and urge them to begin now to consider a successor to ESAF. More important, we urge their continued pursuit of sound macroeconomic policies and close dialogue with the Fund.

Mr. Fayolle made the following statement:

Senegal's macroeconomic program remains well on track, and structural reforms are progressing very well, as confirmed in the statement by the staff representative and by Mr. Yao.

The authorities have strengthened further their adjustment efforts in areas where some weaknesses had occurred. As it is the case in many other CFA countries, the implementation of a sound policy mix has contributed to a sharp decline in inflation since the beginning of this ESAF, but, as it is also the case in these countries, the economic and financial situation remains fragile and very vulnerable to external shocks. The authorities' continued adherence to adjustment policies and economic reforms is therefore much welcomed. I think that, as it was already the case last year, the main message we should convey to the authorities is that they should persevere with their adjustment efforts, which are beginning to pay off.

I am in broad agreement with the staff's recommendations and will limit myself to the following four comments.

First, Senegal should maintain its efforts aimed at maintaining a sound fiscal policy, which could imply increasing revenue performance beyond the 16.5 percent of GDP targeted in the policy framework paper for 1999. The overall budgetary performance has been satisfactory so far, taking into account the fact that wages have been and should remain kept well under control. But the authorities are facing two challenges: the need to increase expenditures in the social and education areas and the implementation of the very much welcomed West African Economic and Monetary Union tariff reform.

My second comment is related to structural reforms, which should continue to be implemented forcefully. I was pleased by recent progresses in the legal framework for the private sector, and I look forward to rapid progress in the privatization and the restructuring of the energy sector, including the privatization of the electrical company.

My third comment is related to the level of growth in Senegal. The staff projects a rather prudent growth objective of 4 to 5 percent per year during the program period, which corresponds to a modest 1 to 1 ½ percent increase in GDP per capita. Since agriculture is vulnerable to climatic vagaries, such caution is understandable. However, this level can be considered a bit disappointing, and I was hoping to find elements of explanation in the very interesting occasional paper on reinvigorating growth in developing countries published last July. But, after having read the key lessons for program design that emerged from the eight countries studied, among them Senegal, I still fail to understand why growth in Senegal is not higher. Indeed, Senegal seems to fulfil all the conditions. So I am looking forward to the coming Policy Development and Review Department's review of ESAF programs, which will, if I understand correctly, thoroughly analyze this issue.

We have to look for ways to help the authorities to generate better growth prospects. Like in the case of Mali a few months ago, I am referring here to the deepening of regional integration among West African countries, and I am very pleased to see the progress made in this area and the role Senegal played in these developments. Maybe a more precise analysis of the agricultural and manufacturing sectors and their contribution to growth would give us elements to better understand the situation in Senegal.

Finally, I must confess that I was disappointed by the debt sustainability analysis. The authorities are to be commended for their wish that, as expressed in the policy framework paper, a continued implementation of sound macroeconomic policies will allow Senegal to maintain a sustainable medium- and long-term debt position. But, before coming to this conclusion, a more precise analysis is needed.

First, taking into account the high vulnerability of Senegal to external shocks, I think the debt sustainability analysis should include more hypotheses for assessing the impact of this vulnerability on the debt situation. Second, on page 59 of the paper there is a very interesting reference to the consequence of the high fiscal burden of debt service obligation which "would make it more difficult to achieve the increase in investment needed to establish conditions for high growth." This is a very important issue which may allow us to understand why the level of growth is still low in Senegal. I would have liked this debt sustainability analysis to include a much more precise analysis of this factor, as it has been one of the elements mentioned during the debate on heavily indebted poor countries we have had before the Annual Meetings. Therefore, I hope that the debt sustainability analysis scheduled later this year will include all the elements required to fairly assess the situation of Senegal.

Mr. Giustiniani made the following statement:

The efforts made, and the results achieved, by the Senegalese authorities in the recent past are impressive and have to be welcomed. However, the country's economic situation remains challenging, and the objectives set in the program are sound. We believe that the program deserves to be completed as agreed, and would simply like to call the Board's attention to three specific issues.

First, on the fiscal side, the program aimed at the reduction of the budget deficit contained appreciable risks. Over the period ending in 1999, the increase in total revenues seems to be modest. Taxes on international trade remain broadly constant in terms of GDP, notwithstanding the expected harmonization of tariffs in the context of the West African Economic and Monetary Union (WAEMU). This implies, as it has been assumed by the staff, a rate of expansion of trade higher than that of GDP. Most of the increase in tax revenues stems from both direct and indirect taxes, which entails a strengthening in tax administration and a reform of the taxation system on petroleum products. In conclusion, we notice that the achievement of the deficit target depends on the continued success of a series of actions, on both the revenue and expenditure side, that are all incremental and all essential. There is practically no room for error.

Second, on the monetary side, the efforts already made to support the expansion of credit to the private sector are in the right direction. The diffusion of credit institutions is positive. Nevertheless, the new small credit institutions which entered the market during 1995 may become a cause of concern if supervision on their initial performance is not based on a supervisory process and data that are adequate to the purpose. Standards also have to be more exacting than the normal ones. Where banks constitute the sole channel of distribution of financial resources and financial stability is far from being guaranteed, the expansion of the banking sector should be accompanied by a plan aimed at a strengthening of the supervisory system.

Third, as far as the privatization program is concerned, we favorably assess the Senegalese authorities' commitment. However, the objective of privatizing 18 enterprises after last year's negative performance becomes crucial in order not to undermine the credibility of the program itself. We note that, therefore, the railroad sector privatization depends on the legislative action that may come too late to permit the completion of the process. With these comments, we support the proposed decision.

Mr. Munthali made the following statement:

The progress that Senegal has made thus far in the implementation of its economic adjustment and reform program is becoming apparent from the key macroeconomic indicators. Real GDP growth has been strong and significantly above the rate of population growth since 1995. The authorities expect an equally strong performance this year which should once again provide a further increase in per capita income for the third year in a row. This would appear to confirm the assessment by the staff that the improvement in economic conditions in Senegal is becoming visible, especially if rural incomes have indeed benefited from the liberalization and reform efforts in the agricultural sector. As the authorities implement their third-year program in 1997, it is important that the process of reinforcing these gains be sustained in order to allow greater visibility of the improved economic conditions which would facilitate in mustering the consensus for continued adjustment and reform.

Notwithstanding the significant progress achieved to date, the medium and long-term balance of payments projections underscore the need for the authorities to stay the course even after the completion of the current program. It is clear that the production and export base remain fragile as diversification has not yet taken a firm hold to provide the needed resilience of the economy against exogenous shocks. The vulnerability of the economy to these shocks, including the effects of adverse Sahelian weather and the weaknesses in the terms of trade which the country has experienced in recent years, will undoubtedly require the continued implementation of prudent macroeconomic policies and the deepening of structural reforms.

Thus far, the authorities have demonstrated their commitment to the pursuit of sound financial and economic policies, with the determined implementation of all the measures under the program. Among other things, this resulted in an impressive, sharp reduction in inflation following the surge that took place after the zone-wide exchange rate correction in 1994. The fixed exchange rate provided a credible anchor for domestic prices and, in combination with the pursuit of restrictive financial policies that resulted in commendable progress toward fiscal consolidation, facilitated the early attainment of the inflation objective.

Under the current program, it will be important to reinforce the credibility of fiscal policy by generating and strengthening the basic balance surplus as planned in order to fund critical domestic programs, especially those in the social sectors of education and health. The mix of revenue-enhancing and expenditure restraining measures have been appropriately designed to promote savings and investment and discourage consumption. The widening of the coverage of the value-added tax together with other administrative actions to enhance tax efficiency are pertinent actions in this regard. Besides, the use of exceptional receipts from privatization of public sector enterprises to retire domestic bank and nonbank liabilities and to fund investment programs, including infrastructural projects, will also be important in facilitating the expansion of the productive base.

On the expenditure side, the authorities should be encouraged to reorient spending priorities toward those areas that promote the expansion of the productive base. Hence, increased expenditure on education and health has the advantage of not only strengthening human capital stock and promoting the productivity labor but also making the impact of economic reforms more visible. While endorsing the intention of the authorities not to grant a general wage increase in 1997, reasonable and justifiable adjustments, linked preferably to productivity gains, should be carefully planned in the ensuing period to avoid sudden and sharp increases at a later stage.

The 1997 program takes a significant step forward by accelerating the pace of reforms that would enhance economic efficiency. For example, the legal and judicial reforms would provide a clear and transparent framework for the private sector investment and it bodes well for the privatization of state enterprises which has also been stepped up. All this should help to boost business confidence. However, the authorities need to exercise patience as these reforms take time to bear fruit; they do not quickly spark increased investment as experience has shown elsewhere in sub-Saharan Africa. Nevertheless, the government should be encouraged to take a more proactive approach in promoting private sector investments by, among other policy initiatives, addressing infrastructural and other technological barriers in the context of the investment program and with the assistance of the World Bank.

We agree with the authorities that poverty alleviation would depend on the success of sustaining a strong growth over the medium term. The promotion of productivity in agriculture and other productive sectors will be critical in the overall reduction of poverty. The targeted assistance to the disadvantaged members of the society should be undertaken as an integral part of the human resource development, especially with the focus on the role of women.

Finally, Senegal's external debt remains burdensome even though indicators may preclude the country from taking advantage of the HIPC initiative at this stage. The impact of debt servicing on government revenue is substantial as the staff has acknowledged. It should be noted that Senegal's main exports of groundnuts and cotton remain highly vulnerable to persistent droughts and the weakness in the external terms of trade. The present debt relief under the Naples terms would be helpful in reducing the debt-service outlays on bilateral debt. Meanwhile, the authorities should continue to follow the evolution of debt indicators closely and the possibility of further HIPC-style relief should remain open in the event of a worsening debt situation.

In sum, we concur that the Senegalese authorities have put together a strong and comprehensive set of measures under the third-year arrangement and we support the proposed decision.

Ms. Kouprianova made the following statement:

Let me join others in commending the authorities for their commitment to the reforms that has resulted in an encouraging improvement of the macroeconomic situation in Senegal. The objectives for 1996 were attained, and the impressive performance of the economy has continued. Real GDP growth is expected to reach 5.2 percent for 1996, the inflation rate was considerably reduced, the fiscal position was improved, several important structural measures were implemented, and the external current account deficit was lowered. These positive developments were supported by the prudent monetary and credit policy stance. Notwithstanding these achievements, considerable policy challenges lie ahead, and the successes achieved need to be sustained, as the economy remains fragile. Given the authorities' ongoing strong commitment to the reform process, we have increasing confidence that they will be able to reach their medium-term objective of sustainable growth, while continuing the process of establishing a good track record of implementation of the Fund programs. We endorse the policy recommendations contained in the staff report, their thrust is consistent with the main objectives of the previous year program. I will limit myself to making two brief comments on fiscal and structural policies.

The fiscal policy area remains on the top of the authorities' reform agenda. Significant progress was achieved in the course of the past year. The overall budget deficit is expected to amount to 2 percent of GDP—a 1.2 percent of GDP reduction compared with 1995. We share the view that in order to eliminate the overall budget deficit by 1998, and to increase domestic savings by almost 3 percent by 1999, the authorities need to strengthen further their fiscal efforts. On the revenue side, we note that the authorities have successfully addressed the past problem of the revenue shortfalls, and have managed to increase the flow of revenues. Nevertheless, we find that with the revenue-GDP ratio of 15 percent there is room for a further increase. The main avenues for pursuing this objective should be the expansion of the tax base, and enhancement of the effectiveness of tax and customs administration. In this regard, we note the magnitude of envisaged measures outlined in paragraph 16 of the authorities' memorandum. Vigorous implementation of all these measures will contribute to the achievement of the fiscal objectives. At the same time, we urge the authorities to analyze early the set of recommendations given by the Fund's technical assistance mission, and to begin implementing those measures in order to ensure a stable revenue flow over the medium-term. On the expenditure side, the need to contain current expenditure is hard to overemphasize. We join others in welcoming the authorities' plan to contain the wage bill and to promote a restrictive recruitment policy in the civil service. However, in our view, just freezing the number of civil servants to the current level may not be sufficient, although it represents an important step in the civil service reform, and we encourage the authorities to explore more ambitious goals in this area.

Second, on structural policy. Progress achieved in this area is commendable, although structural reforms need to be deepened. The authorities' agenda is ambitious enough, and the list of envisaged measures under the program to be implemented in 1997 is extensive. Implementation of the envisaged measures in a timely manner is a prerequisite for overall reform success, as it influences the development progress throughout the economy. One of the main avenues of structural transformation is privatization. The privatization process needs to be speeded up, and, while welcoming the authorities' plan to privatize 18 enterprises by end-1997, we urge them not to delay implementation of all the envisaged steps. More efforts are also needed to speed-up restructuring of the public sector, especially, the energy sector entities, as the results of such a restructuring will notably influence the fiscal outcomes. We note that the authorities adopted a program of action for the reform of the energy sector in December 1996, and we are encouraged by their intentions to undertake a major review of the energy sector in early 1997. One more direction of structural reforms is the agricultural sector restructuring. For a country with more than 70 percent of the population employed in agriculture, the thrust of agricultural policy needs to be well defined. We are encouraged by the authorities' intention to pursue liberalization of this sector, and welcome the measures aimed at reducing the state's role in its functioning.

The reform process in Senegal has been widely supported by the Fund and the World Bank, and the country has benefited greatly from this assistance. We are looking forward to the successful completion of the current program, and we wish the authorities every success in their efforts. This chair supports the proposed decision.

Mr. Tilyayev made the following statement:

Since the beginning of its medium-term adjustment program in early 1994, Senegalese authorities continuously remain committed to the main goals and objectives of the program introduced. The 1995-96 results show significantly achieved progress. Indeed, the real GDP grew by approximately 5.2 percent in 1996, against 2.0 percent in 1994. An appropriate monetary policy led to a decline in inflation rate to 3 percent in 1996, and the external current account deficit was essentially reduced as well. By maintaining a strict fiscal discipline, the authorities reduced the fiscal deficit to an estimated 1.9 percent of GDP in 1996 against 5.7 percent in 1994. I would gladly join others in commending the authorities for these achievements. In general, the Senegalese economy has responded positively to the adjustment efforts introduced with the ESAF program.

However, despite the overall positive achievements, there are still some difficulties and setbacks to be faced. Most of those problems were already disclosed by previous speakers. So, I will limit myself to several remarks just for the emphasis.

In regards to the need for better revenue performance, the magnitude of the problem was already underscored during previous discussions. Taking into account the authorities' intention to continue to restrain government spendings in order to allocate more resources for basic health and education, it is essential to raise the ratio of government revenue to GDP above the current level of about 15 percent. There was improvement in that area. However, the gains were offset by a significant shortfall in petroleum revenues due to the fail in adjusting domestic prices to reflect the rise in world market prices. In that context, the authorities should be urged to shift the priorities to measures that will further improve tax and customs administration, reduce fiscal fraud, and widen the tax base.

In the area of structural reforms, we can observe that the Senegalese authorities are continuing the implementation of the ambitious program of price and trade liberalization, public enterprise streamlining, extensive privatization, and agricultural sector reform, to consolidate the progress already made. However, the delays in the reform of the energy sector, which was addressed to improve efficiency and lower electricity production costs, should be of more concern to the authorities.

The authorities also should be urged to address the issue of weaknesses in data collection and in the compilation of the national accounts, which contribute to the difficulties in estimating the performance figures.

Finally, we support the authorities' request for the third annual arrangement under the ESAF and wish them all the success in their further endeavors.

Mr. Loevinger made the following statement:

Like other Directors, we commend the authorities for the progress they have made under the program. As other speakers have noted, macroeconomic imbalances have been significantly reduced. As a result, we agree with the staff that the debt burden seems sustainable when looking at the overall economy.

However, the debt servicing burden remains high as a percentage of government revenues. We thus wonder whether the authorities should take additional measures to increase revenues. It was encouraging to hear from Mr. Yao that government revenues exceeded the program target this year. Higher revenues would increase the government's capacity to service its debt, and make their debt servicing capacity much less vulnerable to external shocks. It would also allow much needed increases in spending on health and education. It was disappointing to see on table 11 that primary school enrollment ratios, and illiteracy rates have barely changed since the early 1980s. This has got to be a significant constraint on growth. Higher revenues would also reduce the risk that further exceptional external financing would be needed in the future, including a follow-on ESAF.

In addition to raising the level of revenues, we urge both the staff and the authorities also to look at ways of improving the composition of revenues. It is disappointing to see that trade taxes as a percentage of total tax revenue have increased under the program. We urge the authorities to use the planned cuts in intra-WAEMU tariffs as an opportunity to reduce their reliance on trade taxes. As this chair recently noted in the discussion of Niger, we are concerned about the proposal to increase tariffs on non-WAEMU imports. As we said then, regional trade liberalization should be trade-creating, not trade-diverting.

Despite all the progress made reducing macroeconomic imbalances, progress on structural reforms has been less impressive, particularly regarding privatizations. It would be interesting to hear from the World Bank representative why privatizations have been so slow. This may explain why growth rates have been so low. I am not sure what is meant by the plan to privatize management. Would the government still hold shares?

Finally, it is good to see the authorities intend to publish the policy framework paper, we encourage them to do so.

Mr. Himani made the following statement:

I welcome the progress made by Senegal under the ESAF arrangement. The authorities' strong commitment to adjustment and reform has been well rewarded. Indeed, Senegal has largely succeeded in laying down a significant part of the groundwork for a sustainable economic environment.

This being said, there remains a need for heightened vigilance in the years ahead. Specifically, while important structural reforms have been implemented, a significant agenda of reforms remains outstanding.

Furthermore, Senegal's economy will likely to continue to be vulnerable to external developments for some time to come.

Consolidating the gains of recent years is the main objective. To this end, continued efforts to ensure a durable and sustainable improvement in the fiscal stance in will be key. Here, the measures to improve tax administration are particularly encouraging. Broadening the domestic tax base will also be critical, especially in view of the planned introduction of a common tariff with other members of WAEMU.

The banking sector in Senegal is relatively sound. This places Senegal in an advantageous position to take a lead in measures geared at enhancing financial deepening and refining instruments of indirect monetary policy in cooperation with its Central Bank of West African States (BCEAO) partners.

Accelerating the pace of structural reforms should further strengthen the private sector. The measures envisaged under the program are both far reaching and well balanced.

In sum, Senegal's program is ambitious and the authorities have demonstrated their commitment to reform. Looking to the future, the Fund should stand ready to continue to provide assistance to the authorities in meeting the challenges ahead. I support the proposed decision and wish them every success.

Mr. Alemán made the following statement:

The staff papers prepared for Senegal's request for a third annual arrangement under ESAF, and Mr. Yao's statement, provide us with helpful information to evaluate the progress made and the medium-term outlook of Senegal's economy. I, as other speakers, would like to commend the Senegalese authorities for their success in managing their economic program.

The progress achieved by the Senegalese authorities is encouraging. We concur with Mr. Yao's statement, and with the staff, that Senegal has made important progress in the implementation of its structural program. The economic progress and financial performance achieved by Senegal during 1995 and 1996 are remarkable. Since most of the program's targets will be met in 1996, and the overall implementation of the 1995-96 program was on track, the outlook for 1997 indicates that all the targets could also be attained.

Since Senegal initiated its adjustment reform policies in early 1994, the authorities have shown a strong commitment to continuing their comprehensive structural adjustment program. The Senegalese authorities have renewed their pledge to strengthening their revenue mobilization efforts and to accelerating the implementation of the structural reform. The policies and actions contemplated for 1997 and the 1998-99 period will undoubtedly consolidate the success already achieved in past years. The outcomes in terms of growth, inflation, and other macroeconomic variables for 1995 and 1996 are encouraging. Since I am in broad agreement with the staff appraisal, let me make only a few remarks.

On the fiscal side, I would like to point out that, in order to achieve a sustained growth path, the public sector should contribute to improve the national savings effort. The authorities should continue to tackle the weaknesses in the public administration to reduce the fiscal deficit. This should be achieved not only by the improvement of revenue performance but especially by preventing expenditure overruns, and persevering with overall government expenditure restraint. This will permit an increase in social expenditure on basic health, education, the social safety net, and also in public investment.

On structural reform, although important improvements were made in 1995 and 1996 in various sectors, we urge the authorities to rapidly implement further price liberalization schemes, especially for petroleum products. It is important to emphasize the need to move ahead in the reform program on privatization, the legal framework, and the problems in the energy, transportation, agricultural, and communications sectors.

External support continues to be essential to achieve a sound balance of payments position. In this sense, the international community is required to continue providing Senegal with wide financial support on concessional terms. Regarding the external debt sustainability analysis, as other speakers I would like to hear the staff's comments on the fiscal burden on Senegal's external debt service.

Finally, other policy actions that the Senegalese authorities have taken, combined with their renewed commitment, should produce excellent results in the near future. We support the proposed decision, and wish the authorities well in their future endeavors.

Mr. Guennewich said that he shared Mr. Loevinger's view that Senegal's debt situation was sustainable.

Mrs. Sein made the following statement:

This chair would like to thank the staff for a clear, concise and comprehensive report on Senegal's economy.

We note the efforts of the authorities in implementing policies to obtain stable and sustainable economic growth and would like to commend them for satisfactorily meeting the objectives of the first two annual ESAF-supported programs. As a result of successfully taking appropriate fiscal, monetary, and structural reform measures, the economy is growing steadily, fiscal situation is improving, monetary growth is decreasing and inflation is falling.

In the fiscal sector, continued implementation of prudent reform measures are encouraged in order to further improve the budgetary conditions. As stated by the staff, the authorities are encouraged to continue putting high priority to measures that will improve the government's revenue performance while, at the same time, maintain a restrained overall government spending. However, as human resource development is essential for economic development of a country, we welcome the authorities' intention to give priority to social spending (especially for health and education).

We note that investment and savings have been increasing over the past couple of years. As the rate of increase in savings is slower than the rate of increase in investment, we urge the authorities to take necessary steps in order to induce increased savings.

We welcome the authorities' intention to continue implementing adjustment measures in order to establish strong and sustainable growth with the private sector playing a larger and more active role. In this regard, we welcome the authorities' acceleration of their privatization process.

We are hopeful that the authorities will be able to implement their program objectives for 1997-99 successfully, as they have done for the past two years and wish them every success in their future tasks.

We note and recognize the authorities' resolve and commitment to carry out the adjustment program. I would now conclude by saying that our chair supports the proposed decision.

The staff representative from the African Department said that Senegal had made substantial progress in recent years in the implementation of its adjustment program. In spite of that progress, the average rates of real growth included in the macroeconomic framework appeared to be relatively low at about 4.5 percent per year. As indicated in the staff report, the authorities themselves expected to boost the medium-term growth potential above the level of 4.5 percent. However, the staff was of the view that the Senegalese economy was still fragile, and was subject to variations in weather conditions and its terms of trade. Moreover, a sustained improvement in the business climate would be necessary to attract private investment and expand and develop the industrial sectors before growth would become more robust. For those reasons, the staff had placed considerable emphasis on the need to accelerate the momentum of reform with respect to privatization, the legal system, the regulatory framework, and the financial system.

The spread between the price of groundnuts in the informal and formal sectors was not significant, the staff representative said. The price in the informal sector was little more than 2 percent above the price in the formal sector. Therefore, unification of the price was not likely to have a significant impact on the production of groundnuts. Moreover, the movement in the spread was erratic and was linked to the evolution of the price of substitutes such as meat and fish.

The staff recognized that the tax effort in Senegal appeared low, at 15 percent of GDP, the staff representative remarked. The apparently low tax effort was not an issue of tax rates. It had more to do with the effectiveness of the customs and tax administration, and on the narrowness of the tax base. Broadening the tax base would involve bringing the informal sector into the tax net, and curtailing the use of tax concessions under the investment code. In Senegal, most of the large modern enterprises were still benefiting from large tax concessions granted in previous years, and those concessions could not be rolled back quickly. Moreover, any curtailment of concessions would have to be done in the context of the regional objective of replacing present individual investment codes with a generalized system of investment incentives.

Mr. Loevinger asked how regional cooperation on tax incentives could be achieved.

The staff representative from the African Department noted that the eight WAEMU countries had set the ambitious timetable of reaching a consensus on regionally-harmonized investment codes before the end of 1997. It would be important that those individual investment codes recognize the importance of providing incentives on as broad a basis as possible, not limiting themselves to new investments by new investors.

Information on the structure of taxation in the staff report overestimated the relative contribution of customs duties because the category of taxes on international trade included the value-added tax collected on imports, which was equivalent to about one third of total taxes on international trade, the staff representative said. By excluding the value-added tax, import taxes would account for only one-third of government revenue, which was more in line with what would be observed for most developing countries.

Senegal's average effective import duty rate was below that prevailing in most of the developing countries, the staff representative continued. In addition, in the context of the reform of February 1994 following the devaluation of the CFA franc, import duties were reduced on average by 4-5 percentage points. Despite those developments, the staff considered that the import tariff level in Senegal remained higher than that prevailing in the other WAEMU countries, except for Burkina Faso. Discussions had begun on a common external tariff which would try to equalize the level of taxation between the WAEMU countries and to reduce the maximum rates to about 30-35 percent from 45 percent currently.

The level of the so-called "solidarity tax" was only 5 percent of the value of nonregional imports, the staff representative noted. With such a low rate, it was doubtful that the solidarity tax would induce major trade diversion effects. In fact, the solidarity tax replaced the flat tax of 1 percent on imports which had been introduced in the 1980s. That tax was abolished at the time of the establishment of the WAEMU. The purpose of the solidarity tax was to provide temporary compensation for the shortfall in revenue resulting from the reduction in taxes on intra-regional trade. But it was also intended to cover the operational expenses of the WAEMU commission. Nevertheless, although the solidarity tax could be considered low, the staff would recommend to the commission, and to individual members of the union, a move to a different system, perhaps involving an allocation of a fraction of value-added tax receipts for the operation of the commission.

The soundness of the banking system in Senegal had been considerably strengthened in the context of the banking reforms of 1989 and 1991, the staff representative said. All banks were meeting the prudential requirement set by the regional banking commission, except for two minor banks whose aggregate assets did not exceed 7 percent of the total assets of the banking system. In 1995, for the first time since the banking crisis, the overall banking sector had generated a net profit after provisioning for nonperforming assets. That had been possible not only because of a slight interest rate spread, but also because the need to provision nonperforming assets had been reduced significantly. It should be noted that the ratio, for the whole banking system, of gross nonperforming assets to total assets had been reduced from about 8 percent to 6 percent. Nevertheless, the banking sector could still be considered weak to the extent that the capital base in the WAEMU countries was only about 5 percent of total assets, which was below international standards.

There was also a need, as in the other countries in the region, to modernize the financial sector by developing nonbank institutions such as leasing companies, the staff representative commented. The role of savings banks and credit unions had expanded considerably over the previous few years, but the operations of such financial institutions remained very modest, not exceeding more than 1 or 2 percent of total credit extended by the financial sector.

Regarding the debt sustainability analysis, Senegal was clearly outside the eligibility range agreed in the HIPC initiative, the staff representative considered. Nevertheless, the debt service ratio in terms of government revenue was relatively high. For that reason, Senegal would need appropriate treatment in the context of the debt reduction operation by the Paris Club and other donors. Detailed analysis would be conducted in the course of the year, and would certainly include all the elements of "vulnerability" that Mr. Fayolle had mentioned.

The staff representative from the Policy Development and Review Department considered that Senegal's eligibility under the HIPC initiative remained open. It was the staff's intention to bring Senegal to the decision point toward the end of 1997, and at that time a fresh debt-sustainability analysis would be undertaken. It was also to be borne in mind that the 1995 agreement with the Paris Club contained a goodwill clause for a stock of debt operation at about the same time. If that clause were to be activated, Senegal and the Paris Club would take the stock of debt operation at that time.

Under the HIPC initiative it was clear that there were two well-defined criteria to decide whether a country would be eligible for HIPC relief or not, the staff representative noted. Those two criteria were the net present value of debt to exports, and the debt service ratio. Both criteria had been expressed as a range. Looking at the ratios for Senegal, and projecting them in the future, it appeared that they would be below the lower end of the two ratios. For that reason, the staff's preliminary analysis indicated that Senegal would not be eligible for HIPC debt relief. But that situation remained open until the next debt sustainability analysis was undertaken.

The staff representative from the World Bank said that considerable progress had been made in privatization, particularly in the water and telecommunications sectors. However, progress had not been as fast as anticipated for several reasons. First, the Senegalese authorities did not wish to privatize for the sake of privatization. Rather they had sought to maximize the revenue from privatization in order to retire some of the liabilities of the government. For that reason several bid launches had been unsuccessful because of the less than stellar performance by some investment banks that were assisting the authorities at the time. Second, there were other obstacles with regard to investment incentives that the authorities had not yet removed. Third, the initial commitment to the privatization program was less strong than it ought to have been. In that regard however, it was necessary to distinguish between political commitment, which was quite strong, and "bureaucratic" commitment, which had been slower to materialize. The authorities' bold decision to privatize the electricity corporation represented a strong signal that the bureaucratic commitment was now more evident.

Mr. Yao made the following concluding statement:

Let me first thank Directors for their encouraging comments and support for Senegal's adjustment efforts. I would like to assure you that, as usual, your concerns and recommendations will be conveyed in full to my authorities. I would also like to thank the staff representative for his concise answers to questions raised by Directors.

I would like at this juncture to focus my remarks on revenue performance and structural reforms.

My authorities attached the utmost importance to the adjustment process and are ready to strengthen the revenue performance and speed up the pace of structural measures in order to keep the program in line with its objectives as illustrated in the 1997 budget adopted by the National Assembly in December 1996.

Regarding revenue performance, my authorities plan to continue to broaden the tax base and strengthen customs tax administration. In addition, an upward adjustment in petroleum price will be considered, if necessary. As to the structural measures, the political commitment to privatize is evident; my authorities hope to reinforce the administrative capacity to carry out the political decisions.

Finally, I would like to convey my authorities' appreciation to the staff representative and his team for their assistance and advice during the last mission in Dakar.

The Executive Board took the following decision:

1. The government of Senegal has requested the third annual arrangement under the Enhanced Structural Adjustment Facility.

2. The Fund has appraised the progress of Senegal in implementing economic policies and achieving the objectives of the program supported by the second annual arrangement, and notes the updated policy framework paper set forth in EBD/96/164.

3. The Fund approves the third annual arrangement set forth in EBS/96/200, Supplement 1.

Decision No. 11419-(97/2), adopted
January 13, 1997

4. GUINEA—1996 ARTICLE IV CONSULTATION; AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1996 Article IV consultation with Guinea and Guinea's request for arrangements under the Enhanced Structural Adjustment Facility (ESAF) (EBS/96/204, 12/27/96). They also had before them a policy framework paper for the period 1996–99 (EBD/96/165, 12/27/96) and a statistical annex (SM/96/305, 12/27/96).

The staff representative from the African Department made the following statement:

The following information has become available since the issuance of the staff report:

Preliminary figures suggest that nonmining government revenue in the fourth quarter of 1996 amounted to GF 68 billion, compared with a program benchmark of GF 83 billion. The preliminary outturn for October-November 1996 indicated a shortfall across all sources of nonmining revenue. In December, however, customs revenue is reported to have caught up with, and even exceeded, the cumulative target for the quarter, with the remaining shortfall concentrated in domestic indirect taxes, in particular the value-added tax. In response to the revenue shortfall, and with a view to meeting the program targets in terms of the primary budget surplus (a performance criterion for end-March 1997), the authorities have been implementing expenditure reductions. The preliminary figure for the government wage bill in the fourth quarter of 1996 suggests a saving relative to the program benchmark (GF 41 billion) of some GF 3 billion, with no evidence of wage arrears. In the meantime, the authorities intend to strengthen further the tax and customs administrations. A short-term technical assistance mission by FAD in the area of value-added tax administration will take place this week, as previously scheduled.

External payments arrears for end-December 1996 are estimated at \$634 million, which includes an amount of about \$27 million of nonreschedulable arrears, mainly to Paris Club creditors, following the settlement of \$20 million of nonreschedulable debt during the fourth quarter of 1996. The authorities intend to clear the remaining nonreschedulable arrears in the coming weeks, ahead of their expected request for debt relief from the Paris Club. Meanwhile, net foreign assets of the central bank at end-December 1996 (\$74 million) were slightly higher than the related benchmark (\$72 million, after adjustment for the excess in external arrears over the program projection).

As envisaged under the program, the central bank has refrained from intervening in the interbank market for foreign exchange, thereby improving its reserve position and allowing for a depreciation of the official exchange rate of 4 percent vis-à-vis the U.S. dollar since mid-November. The benchmark on reserve money for end-December 1996 has been observed.

Mr. Barro Chambrier made the following statement:

After almost three decades under a centrally planned system, Guinea, in December 1985, embarked on a program of structural and institutional reforms aimed at revitalizing the economy, through a determined shift to a market-oriented system. The authorities' adjustment efforts were pursued more forcefully under the first ESAF-supported program launched in 1991 and under which considerable progress was achieved on several fronts. In particular, progress was made in improving the regulatory environment, liberalizing the exchange and trade system, downsizing the public sector and improving its performance. Notwithstanding this progress, the economic performance was below expectations as internal and external imbalances remained large due, inter-alia, to delays in implementing structural reforms, severe terms of trade losses which caused government revenue to decline and the lack of external financial assistance. Also, the response of the private sector to the reform measures did not materialize as expected and is still weak. Meanwhile, Guinea continues to be confronted by limited human resource development and infrastructure constraints.

To address these challenges and to accelerate progress toward a sustained expansion in output, employment and a viable external position, the Guinean authorities have reinforced their adjustment strategy. The reinforcement of this strategy has coincided with the coming to office, in July 1996, of a new government which has indicated its full commitment to the objectives of the adjustment program and to an acceleration of the reform process. In this regard, the new government has moved quickly and has already taken a number of bold steps to strengthen the adjustment process, especially in the fiscal area. With the assistance of the staffs of the Fund and the World Bank, the government has prepared a PFP which builds on the results already obtained, and describes the medium-term strategy for renewed adjustment, as well as the macroeconomic and structural policies to be implemented during the period 1997-99. The macroeconomic objectives are (i) the achievement of an average rate of growth of real GDP of 5 percent; (ii) the containment of inflation at 4 percent annually; and (iii) the reduction in the external current account deficit to 7 percent of GDP.

Consistent with this overall medium-term policy framework, the basic macroeconomic objectives for 1997 are to achieve (i) a real GDP growth of 4.8 percent; (ii) an inflation rate of less than 5 percent; and (iii) an external current account deficit of 8 percent of GDP. To attain these objectives, policies in 1997 will focus on strengthening fiscal discipline and a deepening of structural reforms. In this context, it is to be noted that the government has already taken most of the measures envisaged in the program.

In the fiscal sector, the aim is to increase the primary surplus to 3.1 percent of GDP through an increase in government revenue from 10.5 percent of GDP in 1996 to about 12 percent in 1997, while containing current expenditure at about 9 percent of GDP. This surplus together with expected external assistance will allow for the elimination of remaining external arrears, a reduction in domestic arrears, and less recourse of the government to bank credit.

The increase in revenue will stem primarily from the measures introduced in the second half of 1996 and which are being implemented. Additional measures to limit tax and customs exemptions are being taken, and the authorities have also taken steps to strengthen customs and tax administration by fixing monthly targets for revenue-collecting agencies, extending the scope and activity of the private customs inspection agency, SGS, and taking a number of measures aimed at improving revenue collection. Moreover, the price of gasoline was raised in October and is now more in line with petroleum import costs, and the structure of petroleum prices will be reviewed regularly to ensure that prices reflect costs and expected budgetary revenue.

On the expenditure side, the 1997 budget provides for a leveling off of current expenditure in relation to GDP. The increase in the wage bill will be limited to 2.5 percent, through stricter management of recruitment, and the policy of not replacing retiring agents, except in the health and education sectors, and strict control of wage award. Overall, the ratio of the wage bill to GDP is expected to fall to 4.1 percent of GDP in 1997 compared to 4.4 percent in 1996. Outlays on goods and services will be reduced slightly, while investment expenditure will increase by a little over 1 percentage point of GDP to about 8.7 percent of GDP in 1997, with most of it being foreign-financed.

The government recognizes that a major cause of past fiscal slippages has been the weaknesses in budgetary preparation and management. Therefore, the adjustment program envisages a number of measures aimed at achieving a permanent improvement in fiscal performance. These measures are well described in the authorities' memorandum, as well as outlined in Box 2 at page 12a of the staff report, and they address specific weaknesses that have been noted in the area of tax policy, tax and customs administration as well as tax exemptions. Moreover, the authorities will ensure strict application of budgetary rules, and budgetary preparation will be improved to reflect government priorities in the sectoral allocations. The expenditure process is being made more transparent, and control over the government payroll is being strengthened through computerization of the civil service and payroll files.

Monetary policy will continue to be directed at achieving the inflation objective and protecting the level of external reserves. The programmed reduction in the government's overall indebtedness to the banking system and the reduction in domestic arrears will allow for an increase in credit to the private sector. Measures are being taken to strengthen the liquidity management of the central bank, and the stock of permanent advances will be converted into treasury bills which could be used for open market operations.

Strengthening the banking system, deepening financial intermediation, and improving access to bank credit by the private sector will be important objectives of the present program. In this regard, the authorities are taking a number of steps to strengthen banking supervision and reduce government ownership of banks. They are also preparing a uniform accounting plan to be implemented by all commercial banks. Furthermore, each bank will be subjected to at least one annual on-site inspection, and the authorities have adopted a supervision manual for banks and insurance companies.

On other structural measures, which are aimed at expanding the private sector and accelerating the development of the economy, the authorities are focusing their efforts on areas which have been identified as creating bottlenecks in the economy. These efforts entail the reform of the judicial environment to render it more transparent and thus create more public confidence in its functioning, the reform of the civil service, and that of the public enterprise sector.

In the external sector, the authorities remain committed to a liberal trade and exchange system, and will pursue a flexible exchange rate policy. The Central Bank of Guinea will refrain from maintaining an official exchange rate that is not market-determined and this policy has already been communicated to commercial banks. Moreover, in order to deepen the market and speed up the unification of the exchange rate, the authorities will allow foreign exchange bureaus to participate in the interbank market by end-March 1997. The new exchange rate policy stance, together with the tighter fiscal and monetary policies, being followed by the authorities, are expected to improve Guinea's external competitiveness, which will also be helped by the review of the external trade policies, including the harmonization of trade practices with WTO rules.

Under the present program, Guinea will continue its efforts to normalize relations with its creditors. In this context, the authorities intend to eliminate by early 1997 all arrears not eligible for rescheduling, and also to finalize all remaining debt relief agreements with some of its creditors. As regards its commercial debt, the authorities, with World Bank assistance, intend to conclude negotiations on a buy-back scheme. The debt sustainability analysis prepared by the staff indicates that the implementation of strong adjustment policies together with traditional debt relief mechanisms should help to make the external debt situation manageable over the medium- to long-term. However, as also noted in the staff report, the analysis is subject to a considerable degree of uncertainty related to price fluctuations in Guinea's main exports, and the ratio of external debt service to budgetary revenue is still large. Therefore, while my authorities are well aware of the need to pursue steadfastly with the adjustment process, it is also their view that external financial assistance and stock of debt reduction can contribute importantly to ensuring the country's medium-term financial viability.

In conclusion, it is clear that the Guinean authorities have embarked on a far-reaching and ambitious program of adjustment. The government that took office in July of 1996 has shown a strong commitment to the adjustment process by not hesitating to take quick actions in a number of sensitive areas. They are determined to implement the envisaged measures so as to achieve the objectives of the program, and are hopeful that, in these efforts, they can continue to rely on the assistance of the international community.

Mr. O'Loghlin made the following statement:

This chair supports the approval of the ESAF arrangement proposed in the papers before us. I have only a very few, brief, comments.

First, it is critical that the commitment to adjustment which the new government has shown to date should be sustained. I say that because one could too easily take false comfort from recent economic performance. At first glance, the fact that Guinea repeated in 1996 the solid economic growth rate in evidence over several years now, despite lower grant aid and external investment than in 1995, and did so while maintaining downward pressure on inflation, is encouraging. But it is salutary to note that export receipts on a very broad front fell off significantly, as did overall investment—the basis for future growth—and that economic expansion remained in the 4-to-5 percent range only because imports declined substantially. In that context it is critical to secure stronger confidence in Guinea, in particular so that the fall-off in external investment seen last year will quickly reverse itself.

Second, it seems vital to substantially raise the revenue ratio, which is extremely low at present. The early actions which the new government has taken—to which Mr. Barro Chambrier refers in his statement—are welcome insofar as they will contribute to this, as is the outcome for customs revenue reported in the supplemental staff statement. It seems to me that the low revenue ratio must inhibit growth directly. It restrains public infrastructural development. More important, until educational outlay in Guinea is raised significantly above the 1 percent of GDP which obtained in 1995—and, I assume, in 1996—it seems unavoidable that low primary school enrolment and high illiteracy will also continue to hold the economy back. Rising educational standards have been demonstrated to contribute substantially to economic growth worldwide. The OECD estimated recently that this has been the source of about one quarter of total economic growth over the past 25 years in my own country. Indeed, this leads me to wonder whether there may not be a case, when taxable capacity seems to be underutilized and basic services seem unaffordable at prevailing revenue levels, to incorporate floor levels of revenue as performance criteria in Fund programs. From this standpoint, I welcome the inclusion of an indicative (nonmining) revenue floor in the program now proposed. Of course, compliance with the structural performance criterion relating to the legal basis of customs and indirect tax exemptions is crucial to getting revenues to a more adequate level.

This leads me to a question about another of the indicative benchmarks included in this case—that for central government noninterest current expenditure. The Fund is often characterized as heartless, imposing tough constraint on poor countries which will diminish already-low levels of educational and other social provision. That accusation is normally made in the context of a Fund requirement that the countries concerned improve their overall fiscal balance. But restraints on the overall fiscal balance leave countries the option of deciding at what level to set revenue, and thus leaves them choice about service levels. May I throw it out as a philosophical question whether, by including a ceiling which we do not feel strongly enough about to establish it as a performance criterion, we risk exposing the Fund to less easily-answered criticism for limited gain, if any, in terms of prospective program performance. In raising the question I should add that I appreciate, and agree with, the objective of the staff in specifying this benchmark—to try to ensure that adequate resources are directed to public investment.

May I again confirm this chair's support for the proposed arrangement, and wish the Guinean authorities well in the difficult task ahead.

Mr. Ryan made the following statement:

Guinea's performance in 1996 is a story of apparent contrasts. First half performance was characterized by an unsustainable policy mix in which excessive wage increases were granted following the attempted military coup in February; the fiscal gap widened; and bank credit to the government exceeded targets. The increase in net domestic assets was largely sterilized by the run-down in central bank reserves—mainly in an attempt to maintain the exchange rate—but the situation was clearly not sustainable.

Under performance in the first half, in addition to the long-existing structural shortcomings that pervade the economy, raises the natural question as to whether an new ESAF is now appropriate. On balance, we share staff's view that the proposed arrangement is worth supporting. This view is based importantly on the tangible actions taken by the new government (installed in July 1996) to meaningfully address and correct the web of mismanagement and poor governance that has affected so many aspects of the Guinean economic and business environment. These actions include: hiring a private firm (SGS) to control the customs assessments and collection system; pulling back the second installment of early pay increases to the civil service; taking action to eliminate ghost employees from civil service and military payrolls; reshuffling and demoting personnel to save money and deal with governance problems; and initiating a revision of customs and indirect tax exemptions (the completion of which is a structural performance criterion).

Actions to boost revenues and improve budgetary allocations are needed. Wages and salaries are around 40 percent of revenues. We also understand that spending on the military and foreign ministry accounts for one-quarter of total expenditures. These figures suggest that the provision of goods and services in the social services areas, where the needs are great, have been necessarily limited. Wages as share of GDP do not appear excessive, but in the context of low budget receipts and an inefficient civil service, there is a clear need for a better rationalization of spending.

The new government does appear committed to establishing a more transparent, orderly, and market-friendly business environment. Given Guinea's poor track record, however, it will be essential to put these commitments into practice in order to signal a real departure from the past. Improved "governance" refers to actual developments, not promises. The authorities must avoid situations, for example, in which legitimate businesses face higher expenses due to the closure of various legal loopholes while less scrupulous interests are able to maintain preferences through underhanded dealings. Both the letter and spirit of the law must be observed and enforced or foreign and domestic investment will continue to be discouraged. This will require a strong political commitment at all levels to push ahead with reforms against the opposition of vested interests. Toward this end, implementation of measures to improve the judiciary and to clean-up the government are critical.

Good governance can be enhanced by reducing the scope of government interference in the economy. In this regard, the program's ambitions in the areas of trade liberalization and privatization appear somewhat vague. We recognize the past progress in both areas, but would hope to see a pro-active approach to further liberalization and government divestment in order to boost efficiency and growth prospects. While Guinea's average tariff levels are comparatively low for Africa (around 8 percent), other import fees bring effective taxes up to around 15-20 percent. Recent implementation of the value-added tax should, if effectively administered, help reduce fiscal dependence on trade taxes and allow for a more liberal regime that will complement growth objectives.

Mr. Autheman made the following statement:

While, by and large, Guinea has made good progress toward a market-based economy, there have been repeated episodes of poor policy performance, particularly in fiscal management. Indeed, if I were superstitious, I would be reluctant to support this program, since it appears that Guinea's adjustment experience shows that most of its achievements were made during periods when there was no Fund program, and that slippage often occurred after the approval of the Fund program. Let us hope today that, for the time being, this experience will not be confirmed.

I think that the staff was right to insist that several measures be taken before presenting the program to the Board for approval, both in the structural field and in the correction of past fiscal slippages.

I will make a few comments which go along the lines already followed by previous speakers.

First, I support the strong emphasis on nonmining revenue mobilization. While I am a little concerned that the program already encompasses what looks like a sizable increase in government expenditure, this is certainly justified considering the needs both for infrastructure maintenance and social sectors. Considering the rigidities in the budget stemming from the share of the wage bill which has recently increased, we should be mindful not to allow expenditures to proceed before revenues are collected.

Second, I welcome the tight monetary stance in order to capitalize on earlier gains achieved in reducing inflation. Given the progress made toward indirect instruments for money control, I wonder whether the rationale for maintaining the central bank statutory advances to government is still justified.

Third, on the long-term balance of payments projection, I consider that the staff analysis underscores the importance of maintaining sound policies. Most important, deviations from the baseline scenario would result from the inability to achieve the expected improvement in domestic savings or the expected increase in nonmining export growth, in both cases as a result of weaker policy performance or the absence of an appropriate exchange rate policy. Of course, Guinea's debt needs some external support, and I hope that an improved track record with Paris Club creditors will smooth the way toward such support.

I have to register a reservation related to the assumption made in the staff report on the treatment and mostly the quantification on non–Paris Club claims.

Mr. Botoucharov made the following statement:

I agree with the staff's conclusion that the program for macroeconomic adjustment and structural reforms supported by an ESAF arrangement, produced mixed results in the past years. On the positive side, the relatively high output growth and low inflation are to a great extent evidence of the economy's dynamic response to the achievements in the area of structural reforms. Major reforms undertaken during the period 1991-96 included a successful opening of the economy through liberalization of the trade and exchange system, restructuring and downsizing of the public sector, improvement of the functions of the central bank, and divestiture of large number of public enterprises. Loose financial policies, especially in 1995 and 1996, however, contributed to a considerable worsening of Guinea's domestic and external financial positions. Fiscal slippages prompted a drying up of international financial assistance, and were reflected in a lower than targeted primary surplus and accumulation of domestic and external arrears.

Falling behind the implementation of sound financial policies and the introduction of a number of measures in several areas of structural reform, the authorities acted promptly by announcing a broad set of corrective actions. These actions range from strong fiscal adjustment and tight monetary policy to effective implementation of structural and sectoral reforms. According to the staff, the policies described in the memorandum of economic and financial policies and the actions already taken set up a basis for a program supported by a new ESAF arrangement. In the staff's view the strength of the proposed adjustment program is appropriate for reducing Guinea's economic and financial imbalances, and it would support the authorities' objective to promote strong private sector growth. This chair is, therefore, ready to support the staff's recommendation for approval of the authorities' request for arrangement under the ESAF.

As staff has extensively approached the main problems confronting Guinea's economy and its recommendations are explicitly expressed, I have little to add. I would cover two other areas where particular attention is warranted.

An important issue considered in the staff report is the need for strong fiscal adjustment. In fact, it is obvious that sustainability of the program depends on the achievement of a viable fiscal position, which would bring about an increase in domestic savings and investment and would allow elimination of external and domestic arrears. I, therefore, share staff's view that fiscal consolidation should be a major component of the program. To this end, I welcome Mr. Barro Chambrier's statement that the government recognizes the need of strict implementation of budgetary rules and a permanent improvement in fiscal performance. The authorities have already implemented a number of measures including tightening of tax exemptions and establishment of monthly targets for the revenue-collecting agencies. Further efforts to strengthen tax administration and full commitment to expenditure discipline, however, are needed if the program targets are to be achieved. Especially important seem to be the measures associated with improving tax and customs administration as far as three-quarters of the increase in primary surplus is expected to come from higher revenues without an increase in tax rates. To this end, I welcome the imposition of a number of quantitative and structural performance criteria, which should support the achievement of the fiscal targets.

On the issue of achieving sustainable economic growth, based on greater contribution from the private sector, I welcome the authorities' efforts to improve business environment through judicial reform, financial sector restructuring and progressive withdrawal of the state from the main sectors of the economy. These reforms, accompanied by greater fiscal and monetary discipline, should bring about an increase in domestic savings and investment. In addition, given the very low level of Guinea's social indicators, successful implementation of structural reform measures would support the achievement of the program's social targets.

Mr. Jones made the following statement:

One has to take a long-term view to fully appreciate developments in the Guinean economy—the transformation from a centrally planned economy to one that is market oriented. There is still some ways to go with the process of reform, and the authorities seem to be committed to staying the course. So far, the thrust of economic policies in recent years has produced profound changes which have strengthened the foundation of the economy. The Fund has played an instrumental role in this regard, and this is why I strongly endorse the authorities' request for support under the ESAF.

The net impact of the last ESAF arrangement was an improvement in the living standard of the Guinean people. There was adjustment with growth, even though the outcome was below expectation. However, it is significant that there were gains in real per capita income, and inflation was reduced considerably to less than 4 percent in 1996. The program also saw significant progress in the area of structural reform. Taking all of this together, one can say that, by and large, the authorities deserve commendation and continued support from the international, especially against the background of the significant deterioration in the terms of trade since 1990.

I agree with the general orientation of the medium-term strategy. There are three features that are particularly important: the emphasis on financial discipline and the strengthening of the revenue effort; the priority given to enhancing the role of the private sector; and the focus on combating poverty by improving the supply of basic health and primary education. I welcome the fact that the authorities have already adopted a large part of the structural and sectoral measures for 1997. This is evidence of their commitment to reforming the economy.

The debt burden remains a serious constraint to Guinea's development efforts. The debt sustainability analysis, as the staff acknowledge, is subject to considerable uncertainty. Also, the ratio of debt service to revenue is large. These need to be taken into account in providing debt relief to Guinea.

Mr. Borpujari made the following statement:

This chair is encouraged that Guinea's per capita income continues to grow and, since 1993, there has been a marked slowdown in inflation. The fiscal and external payments positions have also improved, although not by as much as was programmed for. Notably, these achievements have come despite a backdrop of sharp terms of trade losses and lower aid inflows. This is testimony that the economy's resilience has improved following the market-oriented reforms since 1985.

It is unfortunate, however, that there was a serious lapse in fiscal discipline in the wake of the internal difficulties of early 1996. While the deterioration was contained after a new government came to power in July, I fully agree with the staff that stepped up efforts are critical for higher and sustained growth. The comprehensive ESAF program before us is thus reassuring.

Improved fiscal discipline is appropriately the program's first priority. On the revenue front, the emphasis on stricter implementation of existing taxes and elimination of exemptions is well placed. Also welcome are the stepped up efforts to contain budgetary spending and to bring greater market discipline to the public enterprises. Full implementation of reforms contemplated in these areas is a priority.

That being said, I have misgivings on the realism of the program target of a more than twofold rise in the primary fiscal surplus to 3.1 percent of GDP in 1997. I can appreciate the strong concerns expressed in the staff report over Guinea's past uneven record on program implementation. Indeed, the report notes risks that the authorities may have in fact overestimated the capacity to enforce the proposed fiscal adjustment. As the staff rightly stresses, avoidance of further policy slippages is critical for restoration of business confidence. It may thus be prudent to contemplate a time stretch or additional contingency measures to ensure program conformity. Staff comments will be welcome.

Preservation of gains on the inflation front will require a continued tightness in monetary policy. I am encouraged that the central bank is to take on a more proactive role in that regard. The reduction of both the central bank's claims on the government and the latter's domestic arrears are critical for a healthy expansion of private sector credit. I also share the staff's emphasis on a more flexible exchange rate management, improved supervision of banks, and an enhanced weight to indirect monetary controls.

On the structural reform front, the program's strong emphasis on a more dependable legal and regulatory environment is appropriate. An early action plan for judicial reforms is a priority. I also urge a speed up of the civil service reform envisaged in consultation with the World Bank. While the actions contemplated for strengthening of the public enterprises will be a step in the right direction, a speed up of the privatization effort remains essential.

With these remarks, I support the proposed decision and wish the Guinean authorities success in the difficult challenges that are ahead.

Mr. Heinbuecher made the following statement:

We agree with the thrust of staff's analysis and recommendations and can support the proposed decisions. However, we do so with strong reservations in light of the considerable risks described by staff and the not very strong implementation record under former Fund supported programs and with the firm expectation that the external arrears which were intended to be cleared by year-end 1996 will be settled soon. In our view, the approval of Guinea's ESAF-request has to be seen as a large advance of confidence of the international community in the reform willingness of the new government. Guinea's economic and financial problems require a strict implementation of the program and a decisive turning away from the "stop-and-go" policies of previous years.

Guinea has implemented several Fund-supported programs with disappointing results. Previous programs often went off track at an early stage due to repeated slippages in financial policies. Because of implementation problems, technical assistance provided by the Fund has not shown the expected results either (p. 23, para 4). Furthermore, it is regrettable that—after the failure of the previous ESAF arrangement—important improvements that were envisaged in April 1996 (inter alia in public savings and international reserves) were not realized. At that time, it was agreed that negotiations for a new ESAF arrangement should only take place if—within an adequate monitoring period—visible improvements occurred. Against this background, the now completed monitoring period seems to be somewhat short, maybe too short and thus the ESAF request too early, since the new government had only a few months to implement appropriate adjustment measures. In this respect the new data reported by the staff on the revenue performance in the fourth quarter of 1996 are a source of concern. I would, therefore, be interested to learn to what extent Guinea has met the quantitative benchmarks for December 1996 (outlined on page 59), I would appreciate the staff's comments on this.

With regard to fiscal adjustment, the target to increase the primary budget surplus by 1 ½ percentage points of GDP is an important component of the program for 1997. In this context, we welcome the recently adopted quite comprehensive reform package to increase revenue collection, relating in particular to tax and customs administration and the reduction of exemptions (Box 2, p. 12a). However, it is difficult to estimate how fast improvements in fiscal administration in particular will result in an increase of revenues. Problems in the implementation of previous Fund-supported programs have often arisen because of unsatisfactory "governance" and the strength of opposing interests. Whether there is a fundamental change in this area, remains to be seen. In this context, staff has rightly pointed out that—against the backdrop of still existing governance problems considerable risks remain, in particular with regard to the increase in government revenue (p. 4, 24). For this reason the authorities should have contingency measures at hand which could be implemented rapidly to cope with potential program deviations. However, public investments should be exempted from such actions—as they have already declined to a very low level.

With regard to external adjustment, Guinea has not made much progress so far and the program objectives for 1997 do not seem to be very ambitious. Despite the nominal depreciation, the current account deficit is expected to increase slightly. The deterioration in Guinea's terms of trade has certainly made the basic external conditions more difficult. These difficulties call for intensified adjustment efforts, especially for an accelerated diversification of the export base.

At about $711 million in 1997, the projected financing gap is quite large. The complete coverage of this gap still appears to be uncertain. The ongoing rescheduling negotiations with the Paris Club and other bilateral creditors still have to be finalized successfully. Furthermore, it is uncertain whether the authorities' optimistic expectations for additional external assistance will fully materialize. I would appreciate it if staff could provide us with further details and additional information on this important aspect.

Finally, In view of the continuing spread between the official and the market exchange rates, and considering the decline of international reserves, we welcome the authorities' commitment to a flexible exchange rate, and the adopted measures to deepen and to improve the money and foreign exchange markets. In order to avoid putting undue pressure on the exchange rate, it is important that fiscal policy, through strict adherence to budgetary consolidation, and monetary policy, through strict adherence to the objective of price stability, aim to stabilize the confidence which has been gained by the reduction of inflation in the last few years.

Mr. Joyosumarto made the following statement:

At the outset, I would like to express our appreciation to the staff for presenting a concise and clear report on the recent developments in Guinea.

We would like to commend the authorities for implementing the adjustment program. Although implementation has lagged behind the schedule, and there were some slippages, the authorities are to be congratulated for being able to maintain economic growth at a stable rate and lower the inflation rate for the past three years.

With regard to the monetary sector, we note that there is obvious need to increase savings. In this regard, we would like to urge the authorities to take appropriate steps to mobilize savings. We are also of the opinion that investment is on the declining path and that action is needed to induce investment, especially from the private sector. We would like to request that the authorities take measures to increase public confidence in them and to promote increased private sector participation in the economy.

On the fiscal front, we note that the authorities have managed to increase the tax system, broaden the tax base and introduce the value-added tax. Although the primary budget situation is still a surplus, the surplus is less than the projections. We welcome the authorities' determination to strengthen fiscal and government management by implementing reforms in fiscal management.

We welcome the authorities' commitment to further implement structural reforms in order to obtain stable and sustainable growth and wish them every success in their future tasks ahead.

In conclusion, I can support the proposed decision.

The staff representative from the African Department said that, by having a benchmark ceiling on current expenditures, it was not the staff's intention to cap socially oriented expenditures. Instead, a performance criterion had been applied to the primary budget surplus. The two targets, on nonmining revenue and noninterest current expenditure, were intended as supplementary targets to monitor the quality of the fiscal adjustment. In fact, the benchmark ceiling on noninterest current expenditure was intended to protect investment outlays, within the targeted primary budget balance.

The benchmark on the nonmining revenue, according to preliminary information, had not been met, the staff representative confirmed. But there was insufficient information to draw any firm conclusions on performance with regard to total expenditure. However, government expenditure on wages had been slightly reduced. The target on reserve money had been observed, as had the target on net foreign assets.

Regarding the depth of fiscal adjustment, the staff considered that a doubling of the primary surplus was not an unrealistic target because it was a doubling from a very low level of 1.5 percent of GDP, the staff representative remarked. In that regard, the staff had taken great care to set ambitious but realistic targets, given Guinea's relatively low revenue collections.

The staff appraisal could not be considered overly pessimistic, the staff representative remarked. Credit had been given for the government's efforts where that was warranted, particularly in the case of structural reforms. But given the poor revenue performance and the associated poor delivery of basic public services, the authorities' economic performance had been properly characterized as uneven.

The residual financing gap of $623 million was expected to be covered mostly by about $614 of debt relief and the balance from bilateral donors, the staff representative concluded.

Mr. Barro Chambrier made the following concluding statement:

I would like to thank Directors for their support regarding the request by my Guinean authorities for an ESAF arrangement. I have noted carefully the concerns raised by many Directors, and you can be assured that I will transmit these comments faithfully to my authorities.

I would like to reiterate that the government that came to office in July of 1996 is fully committed to the adjustment process. In a short time, it has taken important macroeconomic and structural measures which have corrected some of the weaknesses, especially in the budgetary area. There were some concerns regarding the track record. While it is true that there were slippages in the previous program, one must not forget the political and social conditions that were prevailing then. The country experienced an attempted coup d'etat in February 1996, and there were severe political tensions. Nevertheless, many measures have been implemented, and I think that the new political and social consensus has created an excellent opportunity to move ahead.

The new government is committed to the adjustment effort and has taken steps that have prevented a worsening of the financial situation. I think that this determination deserves the full support of the international community, and this is the time when external assistance can be most effective and have the most positive impact. Delays can only cause a worsening of the situation.

I would like to add that the present program addresses many of the weaknesses that had become evident under the previous program, and it also builds on the progress that had been achieved in many areas. One of the main focuses of the program is on administrative reform. The reforms that are being undertaken are wide-ranging and are expected to bring a permanent improvement to the administrative capacity of the government, especially as regards budgetary procedures and in the monitoring of public expenditure.

Regarding the low ratio of revenue to GDP, as clearly underscored by the staff representative, the key ingredient of the program is to raise the revenue ratio. In this regard, I would note the important steps taken to reduce tax and tariff exemptions, and also to broaden the tax base with a value-added tax. These were not easy decisions, but by taking them my authorities indicated that they were serious about the adjustment process.

The authorities are also addressing the issue of the wage bill and the size of the civil service. Encouraging progress is being achieved in removing ghost workers from the payroll, and the authorities expect to continue their efforts so as to bring the wage bill to a more moderate level. I agree with Mr. Autheman's remark that seems to me very important, which is not to proceed with expenditures before the revenues are there. I think that this is an important point and I will convey that to my authorities. Overall, the authorities understand the need to maintain budgetary discipline, and their efforts under this program are directed at ensuring a permanent improvement in the fiscal situation.

As regards the development of the private sector, the authorities recognize that this has to be given priority. The many measures that will be taken to reform the legal environment, the private sector, the financial, and the mining sectors are aimed at increasing the participation of the private sector in these activities. My authorities are encouraged by the interest that has already been shown by some foreign investors in the mining sector.

In conclusion, let me thank the staff for its dedication and for its advice and assistance, which are highly appreciated by my Guinean authorities. I would also like to thank the staff representative and his team for the cooperative spirit in which the negotiations were conducted.

The Acting Chairman made the following summing up:

Executive Directors were in broad agreement with the staff appraisal. They noted that, under the program supported by the previous arrangements under the Enhanced Structural Adjustment Facility, Guinea had made progress in maintaining positive real per capita GDP growth, reducing inflation, and implementing some core structural reforms. However, they expressed concern about the deterioration in the budgetary situation as well as the external payments position since end-1995.

Directors underscored the urgency of taking corrective actions and regaining the momentum of macroeconomic and structural adjustment to strengthen the basis for future growth and financial stability. They therefore welcomed the firm commitment of the new government to restoring financial discipline, and promoting domestic savings and private investment. In that regard, they noted the importance of fiscal consolidation and careful prioritization of budgetary allocations. Central to the achievement of the fiscal target was the need to increase revenue mobilization through the reduction of tax exemptions, and the strengthening of customs and tax administration. Directors also called for a tightening of expenditure control through a closer monitoring of the wage bill, stricter observance of budgetary rules, and improvement in the areas of budgetary management and transparency. It was also noted that strengthening nonmining revenue would permit reduced reliance on trade taxes and fees. Directors endorsed the priority accorded by the government to investment in basic infrastructure, and to the primary health and education sectors, as well as the authorities' determination to protect basic social expenditures in case of adverse shocks to the budget, given the current deficiencies in Guinea's social conditions.

Directors welcomed the authorities' commitment to a more flexible exchange rate policy, and to deepen the interbank foreign exchange market with a view to speeding up the unification of exchange rates. They noted that Guinea's external debt situation would require continued donor support, and the sustained implementation of sound macroeconomic policies and structural reform. They stressed that an improved track record in policy implementation was needed to secure continued external support.

Directors welcomed the tight monetary stance to consolidate the progress made in reducing inflation. They urged the authorities to reinforce their monetary policy through a more efficient use of indirect instruments, in particular through a deepening of the treasury bill market. These actions, together with the programmed government repayments to the banking system, should allow for the extension of adequate credit to the private sector. Directors also strongly encouraged the authorities to implement the programmed structural reforms necessary to develop a more transparent, orderly, and investor-friendly market environment that is necessary to facilitate private activity with a view to fostering its contribution to growth, and to promoting the diversification of the economy.

Directors underscored the need to improve the efficiency of financial markets and the functioning of the banking system, and, in that context, urged the authorities to strengthen banking supervision. They also welcomed the planned reforms of the judicial system and the ongoing restructuring of ailing banks.

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

The Executive Board took the following decisions:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to Guinea's exchange measure subject to Article VIII, Section 2(a), in the light of the 1996 Article IV consultation with Guinea conducted under Decision No. 5392-(77/63), adopted on April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Guinea maintains a restriction on the making of payments and transfers for current international transactions evidenced by external payments arrears subject to Fund approval under Article VIII, Section 2(a). In the circumstances of Guinea, the Fund approves the retention by Guinea of this restriction until the conclusion of the next Article IV consultation with Guinea or January 31, 1998, whichever is earlier.

Decision No. 11420-(97/2), adopted
January 13, 1997

Enhanced Structural Adjustment Arrangement

1. The government of Guinea has requested a three-year arrangement under the Enhanced Structural Adjustment Facility and the first annual arrangement thereunder.

2. The Fund notes the policy framework paper for Guinea set forth in EBD/96/165.

3. The Fund approves the arrangements set forth in EBS/96/204, Supplement 1.

Decision No. 11421-(97/2), adopted
January 13, 1997

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/1 (1/6/97) and EBM/97/2 (1/13/97).

5. RELATIONS WITH WORLD TRADE ORGANIZATION—AMENDMENT OF SECTION 5 OF BY-LAWS—GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/96/149, Sup. 1, 1/9/97) on the canvass of votes of the Governors on Resolution No. 52–1, with respect to an amendment of Section 5 of the By-Laws. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	1,383,232
Total negative votes	0
Total votes cast	1,383,232
Abstentions recorded	0
Other replies	0
Total replies	1,383,232
Votes of members that did not reply	110,099
Total votes of members	1,493,331

Decision No. 11422-(97/2), adopted
January 9, 1997

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 95/64 and 95/77 are approved.

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/97/1 (1/3/97) and EBAP/97/3 (1/8/97), by Advisors to Executive Directors as set forth in EBAP/97/3 (1/8/97), and by an Assistant to Executive Director as set forth in EBAP/97/2 (1/7/97) is approved.

APPROVAL: March 27, 1997

REINHARD H. MUNZBERG
Secretary