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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 03/39

10:00 a.m., April 28, 2003

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

E. Aninat, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Alazzaz
	M. Kruger, Temporary
	C. Gust, Temporary
	R. von Kleist
	H. Fabig, Temporary
	S. Wolff-Hamacher
M. Callaghan	H. Jang, Temporary
P. Duquesne	A. Requin, Temporary
	I. Kupca, Temporary
	M. Nikitin, Temporary
	I. Alowi
	T. Segara, Temporary
	M. Lundsager
	A. Baukol, Temporary
	J. Prader
	J. Jonas, Temporary
	C. Josz, Temporary
	H. Litman, Temporary
	N. Gigineishvili, Temporary
G. Le Fort	A. Zoccali
	A. Segura, Temporary
	R. Calderón-Colin, Temporary
	M. Daïri
	S. Rouai, Temporary
	Y. Lissovolik, Temporary
	S. Vtyurina, Temporary
D. Ondo Mañe	A. Ismael, Temporary
	J. Santos, Temporary
	D. Lombardi, Temporary
	C. De Silva, Temporary
	R. Gauba, Temporary
	J. Santos, Tempoary
	D. Prasad, Temporary
	M. Brooke
	A. Stuart, Temporary
	O. Kanaan
	K. Sakr, Temporary
I. Usman	J. Kanu, Temporary

Wei B. P. Sun, Temporary
T. Komatsuzaki, Temporary
S. Antic, Temporary
T. Moser, Temporary

S.J. Anjaria, Secretary
B. Esdar, Acting Secretary
H. Mooney, Assistant
O. Vongthieres, Assistant

Also Present
IBRD: P. Alba, Sector Manager; S. El Daher, Financial Sector Advisor. African Department: A. Basu, Deputy Director; A. d'Hoore, N. Lee, L. Schmitz, I. Yakadina, M.Yulek. Legal Department: T. Laryea. Monetary and Exchange Affairs Department: L. Bouscharain, C. Durand, M. El Qorchi, W. Fonteyne. Middle Eastern Department: D. Fanizza, N. Laframboise, M. Lazare, L. Perez, A. Sarr. Office of the Managing Director: A. Mazarei. Policy Development and Review Department: M. Allen, Deputy Director; M. Fisher. Secretary's Department: P. Gotur, L. Hubloue. Advisors to Executive Directors: S. Bakhache, B. Bossone, S. Boucher, S. Çakir, S. Farid, N. Guetat, T. Miyoshi, E. Nyambal, G. Shbikat. Assistants to Executive Directors: A. Alber, D. Ayala, J. Borpujari, P. Dohlman, C. Harzer, J. Kwakye, S. Maherzi, K. Nauphal, J. Sipko, P. Williams.

1. SENEGAL—2002 ARTICLE IV CONSULTATION; POVERTY REDUCTION AND GROWTH FACILITY—THREE-YEAR ARRANGEMENT; AND ENHANCED INITIATIVE FOR HEAVILY INDEBTED POOR COUNTRIES—ADDITIONAL INTERIM ASSISTANCE

Documents: Staff Report for the 2002 Article IV Consultation and Requests for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and for Additional Interim Assistance Under the Enhanced Initiative for Heavily Indebted Poor Countries (EBS/03/49, 4/14/03; and Cor. 1, 4/25/03); and Statistical Appendix (SM/03/131, 4/14/03)

Staff: Schmitz, AFR; Allen, PDR

Length: 1 hour, 45 minutes

The staff representative from the African Department (Ms. Schmitz) submitted the following statement:

> This statement provides additional information that has become available since the issuance of the staff report. This information does not alter the thrust of the staff appraisal.
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> Regarding macroeconomic developments, economic activity does not show signs of being affected by uncertainties in the global outlook. Preliminary data through end-February 2003 for port activity, a good gauge of overall economic developments, were up by about 23 percent above the 2002 monthly average, with transit trade to Mali contributing 3 percentage points. Expansion of credit to the economy at end-March 2003 was in line with program projections, at a 12-month rate of 7 percent. On the downside, the completion of food security surveys in February 2003 confirmed the risk of possible food shortages in some rural areas as a result of last year's small crop, and prompted the government to submit a request for food aid to the donor community. Recent data also suggest that the economy has easily weathered the temporary shock to petroleum prices in the beginning of the year. Energy and fuel prices were up by about 5 percent through March 2003, from December 2002, with the rise in the euro against the dollar mitigating the impact of higher dollar oil prices. This moderate increase in energy prices was offset by a seasonal decline in food prices, resulting in a one percent decline in the consumer price index at end-March 2003, from December 2002. In the 12 months through March 2003, the consumer price index rose by 0.1 percent.
>
> Preliminary fiscal data through March 2003 suggest that total tax revenue rose by 6 percent compared with the first quarter of 2002, but that revenue remained nonetheless slightly below the quarterly program target (to the equivalent of 1.2 percent of projected annual revenue). Net banking credit to the government at end-March 2003 was lower than programmed,

suggesting that expenditure execution in the first quarter of the year was slower than envisaged.

The government has completed the following two sets of prior actions:

First, a Letter of Energy Sector Policy was approved by cabinet on April 8, 2003. The Letter outlines the broad direction of reforms, emphasizing the goal of increased private participation in the energy sector. Specifically, capacity expansion in power generation is to be achieved through private independent power producers (IPPs).The electricity parastatal SENELEC, which would retain exclusivity in transmission and urban distribution, will be privatized through a long-term concession. The privatization of SENELEC is expected to be completed by end-2004.

Second, three pending WAEMU directives on public financial management were adopted in the form of decrees at end-March 2003. In enacting these three directives into national law, Senegal has completed the implementation of the regional legislative framework for (i) public accounting, (ii) the chart of public accounts, and (iii) summary fiscal reporting.

Furthermore in the area of public finance management, the government is requesting that the Fund prepare a ROSC on fiscal transparency, and it has completed the preparatory questionnaire.

As regards reforms targeting the private sector environment, the government has issued in early April 2003 a Letter of Private Sector Development Policy, prepared in the context of a technical assistance project with the World Bank. The Letter outlines measures to improve the efficiency of administrative and fiscal procedures concerning private investment. It also lays out a work program for both the revision of land titling legislation and sectoral regulatory frameworks in the mining, tourism, leather and craft sectors. These issues will also be discussed with representatives of domestic and international private companies, at the next Investors' Council, scheduled for May 5, 2003.

Preliminary indications are that the electricity utility, SENELEC, has met its operational targets for revenue collection and operating costs in the first quarter of 2003. However, SENELEC was able to clear only about CFAF 11 billion of the programmed CFAF 21 billion in payment arrears to suppliers by end-March, as negotiations with local banks for the partial financing of the arrears clearance were not completed on time.

It appears that the implications of last season's poor groundnut harvest for the groundnut parastatal, SONACOS, will be more pronounced than initially envisaged, but that, nonetheless, its financial position will remain satisfactory. Purchases of groundnuts will total only about 15,000 tons in the 2002/03 crop season, against program assumptions of 25,000 tons, and compared with more than 250,000 tons in the 2001/02 crop season. Moreover, SONACOS is expected to sell about 30,000 tons from its inventory to the government to enable the distribution of seed to replenish farmers' seed stocks. Overall, processing and exports of groundnut oil should fall to about 40 thousand tons, against program projections of 50 thousand tons. Finally, in parallel to the preparation of structural reforms in the groundnut sector, a Fund-recruited Senegalese consultant is completing the first phase of a Poverty and Social Impact Analysis (PSIA), with the second phase to be carried out by government and World Bank staff over the next few months.

Mr. Ondo Mañe submitted the following statement:

Introduction

Building on the strong economic performance achieved since the mid 1990s under previous Fund-supported programs, my Senegalese authorities have continued to make progress in the implementation of sound economic policies in 2002. Despite a number of exogenous shocks, including a weather-related drop in agricultural output, the crisis in Côte d'Ivoire and the global economic slowdown, economic growth remained positive, albeit at a lower pace. Inflation was subdued, public finances were strengthened, the financial performance of SONACOS and SENELEC improved, the external position was strengthened, thanks to the combination of strong mining exports and subdued imports; and the full PRSP was submitted to the Fund. Progress was also made in improving the business environment through the establishment of an Investment Council, which has begun to identify obstacles to private investments and proposing solutions based on an action plan prepared by the Private Investment Promotion Agency (APIX). It is to be noted that although there were no Fund-supported program, the Senegalese authorities consulted regularly with Fund staff and continued the implementation of reforms, and the achievements are a vivid testimony of the strong ownership of reforms.

It is also important to note that Senegal was one of the case studies for our discussion on Prolonged Use of Fund Resources. My authorities are convinced that prolonged use is not, per se, a matter of great concern. The most important is the effectiveness of Fund programs to help countries graduate from its resources and possibly exit the Fund-supported program. In this regard, my authorities are making graduation efforts, as the country's sovereign debt has continued to be rated B+ by Standard and Poor's. They intend to prepare an exit strategy that will facilitate the graduation from concessional resources, while maintaining a prudent external borrowing policy. In the period ahead, the authorities intend to take advantage of the WAEMU regional market, and other trade agreements to diversify the export base from groundnuts, fish and phosphates, while bolstering their poverty reduction efforts. Their efforts are also consistent with the NEPAD framework's of eliminating poverty and achieving sustainable growth.

In support of their efforts, my authorities are requesting a new PRGF-supported program and additional interim assistance. Within that program and consistent with the PRSP, my authorities intend to remove administrative, regulatory, judicial and financial constraints to private sector development, and expand social and infrastructure services, while maintaining macroeconomic stability and debt sustainability. They also intend to foster pro-poor growth policies in the rural area and hope to reach the completion point under the Enhanced HIPC Initiative in late 2003.

Recent Economic Developments

In the fiscal area, higher tax revenue and prudent expenditure management have led to the strengthening of public finances. The revenue collection ratio increased to about 17.7 percent of GDP, reflecting the full-year effect of the single VAT rate and steps taken to strengthen tax audits and computerize the tax administration. On the expenditure side, transfer and subsidies were contained. The budget allocations for education and health were expanded to reflect the government's determination to reduce poverty. Moreover, the financial performance of public enterprises improved and the fiscal balance recorded a surplus. Moreover, the government pursued its policy of reducing its domestic arrears.

In the monetary and banking sector, broad money increased by 8.3 percent in 2002 (in line with the nominal GDP), on account of large repatriation of foreign savings in the context of the euro conversion. Net foreign assets strengthened by 8.6 percent, and credit growth was subdued as private and public companies reduced their recourse to the domestic banking sector. My authorities continued to implement the recommendations of the FSAP review report and surveillance of the banking system continued to receive attention. They have revoked the license of a financial institution that did not comply with prudential regulations.

On the structural front, and regarding the groundnut company in particular, my authorities have continued to monitor the situation very closely and its financial performance improved in 2002. A new groundnut sector framework agreement was adopted and SONAGRAINES withdrew from the marketing and transport of groundnuts. In the electricity sector, the 10 percent increase in electricity price decided in March 2002 along with the strengthening of the company's management helped improve SENELEC's financial position. In the postal sector, the postal service continued the reform program with a view to ensuring effective control of financial flows with the treasury. Moreover, the costs of the post office's universal service obligation were estimated and, for the first time, the government made a corresponding budgetary appropriation in the 2003 budget. As regards the National Retirement Fund (FNR), the reform plan adopted has helped turn the FNR's annual net flow to the treasury positive for the first time. Moreover, in the context of the regional convergence framework of the WAEMU, my authorities have adopted a new public procurement code, and have applied the WAEMU directives aimed at strengthening expenditure management.

Medium-Term Program and Policies for 2003

The medium-term objective is to achieve high and equitable growth. The macroeconomic framework for 2003-05 is aligned with the baseline scenario of the PRSP. The medium-term structural agenda focuses on strengthening the efficiency and transparency of public expenditure management, and removing the obstacles to private sector development. For 2003, the economic program aims at achieving a GDP growth rate of 6.6 percent, reflecting the expected return of agricultural output to its trend level. Inflation is expected to remain moderate at about 2.5 percent. The external current account deficit will widen to 7.6 percent of GDP, due to changes in the trade balance. Structural reforms will focus on budget monitoring and control, modernization of tax administration, and on the electricity and groundnut sectors.

Fiscal Policy

The 2003 budget reflects a prudent policy aimed at ensuring long-term fiscal sustainability and allowing room for maneuver in the event of adverse exogenous shocks. Accordingly, this budget will be aligned with the objectives of the PRGF and the PRSP. Reflecting the execution of HIPC Initiative spending with the resources carried over from 2002, the basic fiscal surplus will narrow.

On the revenue side, my authorities will focus on the simplification of the tax system for small and medium enterprises, the continued strengthening of the tax and customs administration, and the preparation of the reform of corporate taxation to support private investment. As regards the modernization of revenue collection, the information technology systems of the Tax Directorate, the Customs Directorate and the Treasury Directorate will be fully integrated by end 2003. Moreover, the introduction of a synthetic tax for small business to replace the VAT, the corporate income tax and the business licensing fees should contribute to bringing the informal sector into the tax net. Should the tax revenue be below target, my authorities stand ready to take the appropriate measures, consistent with the medium-term framework.

As regards expenditures, the policy for 2003 aims at (i) strengthening expenditure management with a view to improving efficiency and transparency, (ii) increasing priority outlays in line with the PRSP, and in the context of aligning the PRSP and the PRGF, (iii) ensuring adequate funding for the costs of structural reforms. The wage policy will remain prudent, although the wage bill is expected to grow, due to the hiring of regular and contractual staff in the education and health sectors. In order to enhance transparency and strengthen expenditure control, my authorities intend to test in the current year the implementation of the WAEMU chart of accounts and the inclusion of treasury execution operations into the integrated expenditure monitoring software. They will also minimize the use of extraordinary budget procedures and overhaul procedures for investment budget execution. To the extent that the implementation of structural reforms could imply costs borne by the budget, the authorities will ensure that such costs are properly assessed and that the requisite appropriations are made, if necessary in a supplementary budget in consultation with Fund staff. They are hopeful to host, in the near future, a mission on the fiscal module of the IMF's ROSC.

Monetary Policy and Banking and Financial Sectors

The objective of the monetary policy, conducted at the regional level by the central bank, is to ensure price stability and the strengthening of the foreign reserves position. In line with the BCEAO regional guidelines, the issuance of treasury bills will be the main domestic source for financing fiscal deficits. Thus, net credit to the government is expected to decrease significantly, leaving sufficient scope for growth of credit to the private sector.

In the financial sector, my authorities will continue to implement the recommendations of the FSAP review mission. To this end, they will pursue their efforts in eliminating the obstacles to a deepening of credit markets, including through strengthening the training of judges in commercial and financial matters. They also intend to strengthen the development of the microfinance sector, mainly in the rural areas as a tool to combat poverty more effectively.

Structural Reforms

My authorities will accelerate the implementation of structural reforms, in order to improve the use of public resources, promote private sector development and foster economic growth. With this in mind, my authorities will pursue the privatization of SENELEC (the electricity company) and SONACOS (the groundnut company). They will ensure that these public enterprises are monitored closely, based on monthly financial and accounting information. At the same time, it should be noted that the restructuring of such sectors carries challenges and difficulties. Since the bulk of poverty is in the rural area where 80 percent of the population lives, with two-thirds depending on the groundnut sector, reforming the sector can take longer than planned because of the need to build a consensus. In this context, the authorities have prepared a Strategic Orientation Framework Paper for the agricultural sector and intend to issue a groundnut sector policy document to redefine the rules of engagement between the sector participants.

In the electricity sector, my authorities have specified the options and procedures for the privatization of SENELEC and intend to issue a tender for a private Independent Power Producer (IPP), in order to ensure the generation of sufficient and high quality electricity at the lowest cost, and expand access. They will also maintain the automatic adjustment mechanism of the petroleum price in the context of the sector's liberalization. In the postal service, my authorities are working closely with the World Bank, in order to strengthen the financial management of the postal service and make it financially independent from the treasury.

As regards governance, my authorities will strengthen public performance within the framework of a program on good governance. They will also reform the judiciary system. To this end, they intend to reinforce human resources, provide ongoing training for judges and clerks, and pursue the modernization of the offices of court clerks. The fight against corruption will also be stepped up with the establishment of a national governance surveillance commission.

In the area of civil service reform, my authorities intend to define, with the assistance of the World Bank and other donors, a medium-term hiring policy to address civil service staffing needs. This policy will also include key elements of a medium-term compensation strategy, which would improve efficiency and governance in the civil service. Accordingly, they will proceed in hiring staff during 2003-05, mainly in the social sectors in line with the PRSP, while keeping the wage bill in conformity with the WAEMU convergence criterion.

As regards the Presidential Large Infrastructure Projects (LIP) under private-public partnership, my authorities have indicated their intention to work closely with Bank and Fund staff to ensure that these projects do not undermine the macroeconomic stability. During the implementation phase, an efficient and transparent management of public resources is also of paramount importance. Moreover, these projects will be financed through BOOTs and BOOs for which my authorities are drafting legislation in consultation with the World Bank. These projects should help contribute to raising the growth rate in the medium to long term, and are consistent with the NEPAD's objective and are being undertaken in the context of improving regional integration.

Debt Sustainability, HIPC Initiative, and Completion Point

My Senegalese authorities have taken the necessary steps to reach the completion point under the Enhanced HIPC Initiative before the end of this year. The macroeconomic performance has been satisfactory. My authorities have sold or liquidated eleven public enterprises. The privatization program is being forcefully pursued with the objective of bringing the remaining operations to a successful conclusion. As regards measures in the education sector, my authorities are pursuing their efforts and intend to achieve the objectives. In the health sector, the implementation of an emergency action plan is expected to lead to significant improvements in main indicators.

On the external debt, my authorities have indicated that they will neither contract nor guarantee external loans at non-concessional terms. Moreover, they will take the necessary measures to enhance debt management capacities.

Conclusion

My Senegalese authorities maintained prudent economic and financial policies after the expiration of the last arrangement in April 2002 and taken steps to minimize the impact of the crisis in Côte d'Ivoire. This is a vivid testimony of their strong commitment and ownership of reforms. However, the economy is still vulnerable to exogenous shocks, as evidenced by the high dependence on a few export commodities.

Building on the country's political and social stability and its recent economic achievements under Fund-supported programs, the authorities are determined to pursue their efforts, in order to achieve strong economic growth and reduce poverty, while maintaining financial viability. To this end, under the new PRGF-supported program, they intend to finish the long-standing structural reform agenda necessary for fostering high growth, and proceed with the implementation of the PRSP, so as to reach the completion point in late 2003. In their reform efforts, the authorities are hopeful that they can continue to rely on additional, timely and predictable assistance of the international community. Technical assistance will also be important to improve capacity building, and to help the authorities identify the sources of growth which will be critical to the achievement of the Millennium Development Goals.

In light of their track record and their determination to strengthen their adjustment efforts, my Senegalese authorities are requesting a new three-year PRGF arrangement and the extension of the interim assistance under the enhanced HIPC Initiative until December 2003.

Mr. Mirakhor submitted the following statement:

Key Points

Senegal has a track record of strong policy implementation that contributed to high growth concurrently with macroeconomic stability;

The 2003 and the medium-term programs appear appropriately configured to achieving the economic and social targets under the PRSP;

The renewed momentum on structural reforms should be maintained to enhance economic efficiency and reduce budgetary costs;

While the medium-term macroeconomic profile looks favorable—despite perceived risks—maintaining prudent financial policies, strong reforms, and efficient debt management is critical;

We support the authorities' request for a new PRGF arrangement and additional interim assistance under the HIPC Initiative.

Senegal has maintained strong growth with macroeconomic stability since the second half of the nineties. This achievement is the result of the implementation of prudent financial policies and reinforcement of structural reforms. Attaining the economic and social targets under the PRSP, in addition to maintaining macroeconomic stability and debt sustainability, will require higher and equitable growth. This calls for a forceful implementation of the remaining reform agenda. The 2003 and medium-term programs appear appropriately configured to meet these challenges. The stocktaking of previous achievements and challenges should inform future policy choices and implementation. In this context, the PRSP identifies the major hindrances to growth and poverty reduction, namely the sharp urban-rural divide, the lack of access to finance, and the high production costs. However, there is an uneven emphasis on these issues under the proposed PRGF-supported program. While the strategy to reduce costs and improve the role of the private sector has been articulated, it is not clear if enough attention is being devoted under the program to reducing the urban-rural divide and improving access to finance. We agree with the thrust of the staff appraisal and support the authorities' request for a new PRGF arrangement and additional interim assistance under the HIPC Initiative.

A prudent fiscal stance in 2002 led to a surplus in overall government operations and a reduction in the domestic debt, while savings on delayed HIPC relief were accumulated at the central bank. While the fiscal balance will shift to a deficit in 2003, this is to accommodate increased expenditure in priority areas of the PRSP and will be financed from HIPC relief and other concessional assistance. Tax revenue is also expected to increase as a result of strengthening of tax and customs administration and consolidation of business taxation. The authorities remain committed to take further measures, when necessary, to safeguard budget implementation. The medium-term fiscal stance is appropriately directed to expanding economic and social services, while safeguarding macroeconomic and debt sustainability.

Prudent monetary policy under the aegis of the West African Economic and Monetary Union (WAEMU) has held inflation at bay, while supporting the exchange rate peg and the buildup of reserves. Future policy will duly restrain monetary growth, underpinned by reducing credit to government while increasing private sector credit. We welcome measures to strengthen the financial system and to promote financial deepening. Improving the regulatory framework of microfinance institutions is important, given their growing influence in the financial system, particularly with regard to the informal sector. Enhancing financial intermediation also requires that contract enforcement and the accounting standards of SMEs be strengthened.

The renewed momentum on structural reforms should be maintained to enhance economic efficiency and reduce budgetary costs. The authorities' plans to advance reforms in the groundnut and electricity sectors are appropriate and welcome. While eventual privatization of SONACOS and SENELEC require careful design and timing, it is important for the authorities to remain resolute and not allow a loss of momentum. In addition, the interest of producers and disadvantaged consumers should be duly safeguarded. The authorities' welcome recognition that expanding rural electrification would enhance economic opportunities in those areas, is not reflected in the priority given to this program. Plans to reform the postal service and pension systems to ensure their financial viability and sustainability are welcome. Initiatives to strengthen economic governance as well as the independence and efficiency of the judicial system should also bolster confidence in the economy.

The medium-term macroeconomic profile looks favorable, despite perceived risks. Real growth is expected to accelerate, while inflation will remain subdued. The external current deficit will be moderate, financed by concessional assistance, and the debt outlook will continue to improve. These optimistic prospects are, however, premised on prudent financial policies, strong reforms, and efficient debt management. Maintaining external debt below HIPC thresholds requires not only modest export growth but also avoidance of costly external financing. Caution is, therefore, necessary in implementing the planned employment and large infrastructure projects, paying due attention to commercial viability and debt sustainability considerations. Achieving economic diversification, necessary to reduce Senegal's vulnerability to shocks, requires that external competitiveness be protected. Progress in trade reform and removal of tariff distortions in the context of the WAEMU common external tariff (CET) should enhance Senegal's competitiveness. The authorities' intention to avail Senegal of the opportunities under the African Growth and Opportunity Act (AGOA) and to develop the tourism industry is a step in the right direction.

Mr. Callaghan submitted the following statement:

Key Points

Senegal demonstrates that macroeconomic stability alone will not result in sustained growth and poverty reduction. Consistent pursuit of structural reforms is also necessary.

It is a concern that against the background of inconsistency in the pursuit of structural reforms in the past, many of the proposed structural policies—particularly in reforming SENELEC and SONACOS—are not defined.

Strict procedures should be introduced to ensure that the expansion of public sector employment does not become excessive and the risks of non-viable large investment projects are avoided.

A key issue is to overcome the reason for the stop-and-go implementation of past programs. Encouraging greater ownership in the program would seem to be the answer.

A stable macroeconomic environment, including in particular generally prudent fiscal policies, during the second half of the 1990s resulted in an improved economic performance compared with earlier periods. However, macroeconomic stability alone has not produced the growth rates necessary to reduce poverty. As highlighted in the staff report and in the PRSP, sustained efforts at removing structural impediments and inefficiencies are necessary in order to lift the economy's overall growth performance and allow it to achieve its poverty reduction targets.

The task ahead is to maintain macroeconomic stability while making more consistent progress on structural reforms, particularly in improving the efficiency of the all important groundnut sector, and improving the environment for greater private sector activity. The concern, however, is that the pursuit of increased growth through expanding social and infrastructure services may compromise macroeconomic stability. In addition, it is also a source of concern that against the background of inconsistency in the pursuit of structural reforms in the past, many of the proposed structural policies under the current program are yet to be fully defined. While noting these concerns, we recognize the authorities' achievements to date, their commitment to proceed with the implementation of their PRSP and support the request for a new three-year PRGF arrangement.

On fiscal policy, the authorities should be commended for the maintenance of prudent fiscal management in 2002 notwithstanding a sizeable decline in economic activity as a result of adverse developments in the agricultural sector. In fact, it is somewhat surprising to see a rise in the fiscal surplus in 2002 to 2.2 per cent of GDP (from a deficit of 0.8 per cent of GDP in 2001) notwithstanding a significant easing in economic growth.

Looking ahead, Senegal faces large public expenditure requirements in order to boost social and physical infrastructure. There is a need to increase the pace of mobilizing domestic revenue. Reforms have seen tax revenue rise from 17.1 per cent of GDP in 2001 to 17.7 per cent in 2002 and it is forecast to reach 18.0 per cent in 2003. While acknowledging that attaining the tax revenue target for 2003 implies a non-trivial revenue effort, the scope of the improvement in tax revenue performance over the life of the program appears modest, rising to only 18.3 per cent of GDP in 2005. The authorities note that in the event of substantial revenue shortfalls, compensating revenue measures would be introduced in order to avoid unpredictable and unprioritized expenditure cuts. Given the magnitude of the development needs facing Senegal, it may be desirable to bring forward now the proposed contingency measures and aim for an even stronger revenue performance.

The proposals for improvements in the timeliness, scope and quality of fiscal reporting are welcome, as is the authorities' commitment to comply with the WAEMU expenditure management reform program. There are, however, two aspects on the expenditure front which need to be carefully monitored. The staff has agreed that an increase in civil service employment was appropriate to alleviate shortages of staff in social services, domestic security and revenue administration. While this may be the case, careful controls are necessary to ensure that this does not lead to an excessive expansion in public sector employment. The staff provides some guidelines for implementing the recruitment policy, however, it is not evident if these guidelines are to be incorporated into an operational framework.

The other potential area of concern is the proposal for a new international airport and toll highway. The staff has noted the long-term quasi-fiscal and governance risks emanating from poorly designed and non-viable large infrastructure projects. While the authorities have agreed on full transparency in the preparation and implementation of these projects, as well as sharing with the Fund and World Bank all information necessary to assess their viability, it would be advisable to establish at the outset some 'hard' procedures and processes to ensure that they will only proceed if viable and any potential call on the public sector is minimized.

The previous PRGF-supported program expired without the conclusion of the last review because of problems in the reform of the electricity and groundnut sectors, as well as reforms in the pension system.

While the financial performance of SENELEC has improved somewhat with a change in management and an increase in electricity tariffs, it is still suffering financial and operational problems. While privatization is the ultimate objective, the past two attempts to privatize the company have not been successful. Steps to address the problems facing SENELEC appear somewhat vague, with the report noting that the authorities intend to seek financing for an emergency investment program. The staff report makes a similar comment with respect to the groundnut parastatal, observing that 'current plans still offered little specific indications on the broader policy agenda for short- to medium-term reforms'. As noted, the lack of precision with respect to reforms is a concern given that they are key areas of the economy and were the reason for the previous program not being completed.

If performance under this program is to be improved, then it is important to overcome the reason for the stop-and-go pattern of program implementation in the past. In short, why will the implementation of this program be different compared with past programs? An important aspect in this regard is that the authorities have instituted public monitoring of PRSP implementation and plan to give the PRGF-supported program a high public profile. This would perhaps be more effective if the PRSP had established a more direct link between the reform measures envisaged and the projected growth rates. Nevertheless, this is an important development and, in keeping with the comments that Mr. Bennett raised on the conclusions of the Taskforce on Prolonged Use, it would have been helpful if the staff had expanded on the steps taken by the authorities to increase 'ownership' of the PRGF-supported program.

Mr. Usman submitted the following statement:

We thank staff for their report and Mr. Ondo Mañe for his detailed and informative preliminary statement. We commend the Senegalese authorities for pursuing prudent macroeconomic policies which have helped to eliminate distortions in the economy, reduced external imbalances and contributed to the achievement of macroeconomic stability. Economic developments in 2002 were however mixed, with a deceleration in real GDP growth, reflecting a severe drought that led to a drop in agricultural output. Despite this development, inflation remained low, and a narrowing of the external current account deficit was also realized on account of strong mining exports and reduced import demand, despite a modest deterioration in the terms of trade.

In light of the above developments, we support the proposed decisions. We agree with the overall thrust of the staff report. We will however, limit our comments to the following areas for emphasis.

Fiscal Policy

We note that while instrumental in achieving financial stability, cash budgeting has impeded the needed improvements in the efficiency of expenditure programs. This has resulted in poor transparency and uneven budget execution, often falling short of the spending targets and planned outcomes. Fiscal management has further been hampered by the effects of weak performance of public entities in key areas and the cash deficits of public entities that hold accounts with the treasury. To ensure an orderly execution of the spending plans, we encourage the authorities to implement a more determined revenue effort than in recent years, to avoid a situation whereby expenditure objectives were sacrificed to compensate for tax revenue shortfalls.

To meet the tax revenue target for 2003, the authorities should pursue additional tax measures consistent with the medium-term objective of having a more efficient, transparent, and business friendly tax system. The reforms in business taxation should avoid granting generous exemptions to investors so as not to undermine the government's revenue-raising efforts. Furthermore, the authorities should avoid recourse to exceptional budgetary procedures, a dominant feature in budget execution in 2002.

Monetary and Financial Sector Issues

We agree with the monetary stance of the authorities, aimed at lowering inflation and strengthening net foreign assets. We note that broad money growth has been boosted by the repatriation of foreign savings in the context of the euro conversion. However, growth of credit in the economy has been subdued due to the recourse of larger private and public enterprises to foreign banks or the domestic bond market.

The soundness of the banking system is commendable. We encourage the authorities to continue the pursuit of strict bank supervision policies so as to avoid the problems of excessive risk concentration and maturity mismatch, which are mostly the consequence of a narrow domestic credit market and limited long-term savings by the public in bank instruments.

We note that poor contract enforcement, lack of minimum accounting standards, and information sharing among banks have contributed towards impeding financial deepening. We encourage the authorities to strengthen the training of judges in commercial and financial law and to enhance the prudential framework for microfinance, in view of the sectors rapid growth. The authorities' efforts in preparing a sector strategy paper to clearly define roles and responsibilities of public agencies in charge of supervision and sector development is therefore welcome.

PRGF and HIPC Issues

We welcome the authorities' efforts towards public monitoring and regular reporting on PRSP implementation with a view to raising the level of responsibility for, and interest in, successful reform implementation. The plan to give the PRGF-supported program a high public profile and the setting up of the committee at cabinet level, reporting directly to the Prime Minister is most welcome. We agree with the authorities assessment that major obstacles such as lack of access to finance; high production costs which reflect persistent inefficiencies in infrastructure and general business risk; inadequate governance and transparency; and labor market rigidities have hindered growth and poverty reduction and no effort should be spared in addressing and overcoming these obstacles.

On HIPC, we note that a stronger capability to measure spending results will be essential for optimizing policy design and execution, and soliciting sustained donor support. Given the weak tracking of HIPC Initiative-related outlays, we urge the authorities to implement more forcefully Fund /Bank staff recommendations.

We agree with Mr. Ondo Mañe that technical assistance from the Fund will be important to improve capacity building and to help the authorities identify the sources of growth which will be critical to the achievement of the Millennium Development Goals. We also agree that given their strong commitment to reform efforts, the authorities deserve the support of the international community in terms of additional, timely and predictable flow of resources.

With the above remarks, we support the request for a new three-year PRGF-supported program and the extension of interim assistance under the HIPC Initiative until December 2003.

We wish the authorities success in their future endeavors.

Mr. Reddy submitted the following statement:

We thank the staff for a well written report and Mr. Ondo Mañe for his useful preliminary statement. We are broadly in agreement with the thrust of staff's appraisal and have the following brief comments.

We commend the Senegalese authorities for their continued sound macroeconomic management in 2002. It is to their credit that despite the impacts of adverse weather conditions and the crisis in Cote d' Ivoire, fiscal consolidation and the cautious monetary stance were adhered to. Consequently, a positive rate of growth was achieved, inflation remained low, and external position strengthened. However, as the authorities recognize, sustained higher levels of equitable growth are required to reduce the incidence of poverty.

In this regard, we are encouraged by the authorities' intentions to implement a broad range of structural reforms in order to fully realize the potential for economic growth and welcome their intention to prepare an exit strategy for graduating from the use of the concessional Fund resources. We support their request for a new PRGF arrangement and additional interim assistance under the HIPC Initiative.

Steadfast implementation of the proposed structural reforms, coupled with increased HIPC–related social sector spending, as envisaged in the PRSP, will be necessary for realization of the goal of poverty reduction. At the same time, we fully appreciate Mr. Ondo Mañe's concerns regarding the challenges involved in the restructuring of some of the key economic sectors. Without detracting from the merit of these reforms, their timing and design have to be carefully planned to safeguard the interests of the large proportion of vulnerable sections of population, such as those dependent on the groundnut sector. We look forward to authorities successfully managing this essential, albeit difficult transition.

During the previous Board discussion, concerns had been expressed regarding the fiscal implications of certain large infrastructure projects. While appreciating the importance of infrastructure to ensure sustained robust growth, and noting the reassurance in Mr. Ondo Mañe's preliminary statement that these will not affect macroeconomic stability, we would have welcomed greater clarity regarding the funding and viability of these projects. We also share Mr. Callaghan's concerns regarding the need to guard against excessive enlargement in public sector employment, while alleviating staff shortages in the essential social sectors.

Finally, we wish the Senegalese authorities success in their challenging policy endeavors.

Mr. Alazzaz submitted the following statement:

I am encouraged that the Senegalese economy continued to grow last year, albeit at a slower pace, despite the drop in agricultural production because of poor weather. Indeed, nonagricultural growth remained strong with activity high in manufacturing as well as construction. The outlook is also promising with growth set to pick up markedly this year in conditions of low inflation and improving fiscal and external positions. However, the situation is still fragile and will require further policy support for the favorable trends to endure. I am therefore reassured by the confirmation of the authorities' policy resolve in the preliminary statement of Mr. Ondo Mañe.

Notably, Senegal has been a prolonged user of Fund resources for over two decades. As in the past, sustaining faster growth is critical for realizing the authorities' goal of reducing the country's high poverty levels. The policy context is also unchanged with the authorities' options principally limited to fiscal policy and structural reforms. The proposed program is thus essentially a follow-up to similar efforts that have been undertaken since 1979. Here, I fully share Mr. Ondo Mañe's view that the most important matter "is the effectiveness of Fund programs to help countries graduate from its resources and possibly exit the Fund-supported program." I therefore welcome the staff's initiative to explore "choices regarding the scope, sequencing and instruments of reforms in a policy options paper."

Indeed, the staff's initiative is in keeping with the recommendation in the Report of the Independent Evaluation Office Report on Evaluation of Prolonged Use of IMF Resources to conduct "a strategic review". Specifically, the IEO Report recommended both a scrutiny of the past for, among other things, "a frank appraisal of previous assumptions about implementation", and an analysis of the prospects in "a discussion of alternative policy options and trade-offs." The IEO also recommended that, "The results of such assessments should be reported candidly to the Executive Board." In that context, a reporting will be particularly relevant and useful in the case of Senegal in view of the indications of tension in setting realistic program goals; as the staff notes in paragraph 21 of the report, "... the authorities viewed the PRSP's more optimistic scenario as a desirably ambitious point of reference ...." Against that background, I will appreciate the staff's elaboration of the findings of its policy options paper, including any strategy for the country's eventual exit from dependence on the use of Fund resources.

Turning to the policy priorities, given the reasonably stable macroeconomic conditions, the policy emphasis is rightly on making up for past delays in implementing the needed structural reforms. In that regard, I share the authorities' high priority for legal, institutional, and regulatory reforms aimed at raising public sector efficiency as well as ending impediments for private sector-led growth. In addition, it important to have early progress in improving the management of public spending and implementing parastatal reforms. The enhanced stress on development of the rural areas is also appropriate.

I welcome the authorities' continued active efforts to foster competitiveness and promote growth through regional integration in the context of the West African Economic and Monetary Union. As the staff highlights in paragraphs 23-24 and Box 4, it is important for the authorities to intensify efforts toward further export diversification, infrastructural improvements, and structural reforms. Indeed, development of additional policy options in this regard is crucial. Here, I welcome the progress with regard to the elimination of tariff distortions, ending explicit non-tariff trade barriers, and moving toward developing a common regional investment code within the WAEMU.

Going forward, I welcome the renewed budgetary emphasis on allocations to improve the social services and the infrastructure in conformity with the PRSP. The systematic approach to civil service reforms and the envisaged introduction of a compensation system geared to productivity growth are also appropriate. On the revenue side, the focus is rightly on simplifying and rationalizing the tax system.

On financial sector reforms, I welcome the authorities' cognizance of the crucial importance of ensuring contract enforcement and setting minimum accounting standards. Here, I look forward to action in follow up to the recommendations of the Financial System Stability Assessment (FSSA). Among other structural reforms, ensuring a flexible labor market in the context of investments in education and training for skill development is crucial.

Finally, the importance of improving the performance of the public enterprises cannot be overstated. Considering the major role these concerns still play in the economy, early progress on this front is essential. That said, I also agree that the privatization of these enterprises should be carefully planned with focus on gains in efficiency rather than a mere change of ownership. In this regard, I welcome the authorities' ongoing efforts for fiscally neutral reform of the enterprises with help from especially the World Bank. Here, I am also encouraged by the authorities' priority for further progress in developing an efficient administrative, regulatory, and judicial environment.

With these remarks, I support the proposed decisions and wish the authorities success.

Mr. Oyarzábal and Mr. Calderón-Colin submitted the following statement:

We will commence by giving the staff our appreciation on the work done on Senegal and for the papers submitted for this meeting. We also want to thank Mr. Ondo Mañe for his comprehensive and candid preliminary statement, which has helped us to better understand the consistent progress of economic policies in Senegal.

At the outset, we would like to support the proposed decisions of approval of a three-year arrangement under the Poverty Reduction and Growth Facility, and of additional HIPC Interim Assistance. According to Mr. Ondo Mañe, with approval of these requests, the authorities intend to remove administrative, regulatory, judicial and financial constraints to private sector development, and expand both social and infrastructure services, while maintaining macroeconomic stability and debt sustainability. We give the authorities recognition for their continued efforts and ambitious plans and encourage them to carry on with their strategy.

Fiscal Policy

We commend the authorities for their prudent management of the public finances. The unification of VAT rates and strong collection efforts were rewarded with a considerable increase in tax revenue, although it was not enough to meet the ambitious target. However, the strict control on expenditure—contained below the target despite the occurrence of several exogenous shocks on the economy as the drop in agricultural output, the global economic slowdown and the conflict in Cote d'Ivoire—helped to keep public finances in line. Given the uncertainty about the timing of total HIPC debt relief prudence was also proved by accumulating unused HIPC resources in a special account at the Central Bank.

We invite the authorities to continue their solid record on public finances by carrying on the pending reforms that could lead to a significant improvement in transparency and efficiency of expenditure programs, and to improve the performance of public entities, as recommended by the staff.

The medium-term fiscal stance is well balanced, being oriented to expanding social and infrastructure services in the context of PRSP implementation, taking into account macroeconomic stability and debt sustainability.

Monetary Policy

Membership in the WAEMU regional arrangement has worked well for Senegal, resulting in low inflation and further sound policies aimed to achieve macroeconomic convergence with the region. According to the staff, Senegal's net foreign assets position at the BCEAO will strengthen in the next couple of years. Net credit to the government will be reduced gradually while maintaining a coherent margin for credit to the private sector. However, although the failure to meet the debt target seems not considerable, we are concerned with regards to the gap to meet the current account deficit ceiling. Staff's comments with respect to the consistency of WAEMU objectives and the PRGF scenario are welcome.

External Sector

Particularly since the medium-term balance of payments outlook seems favorable, we are of the opinion that the level of the current account deficit—even in the medium term—is too high. By addressing deficiencies and making progress on structural reforms, the country will be able, eventually, to attract higher volumes of foreign direct investment and other kinds of private capital flows. Meanwhile, the reduction in financing needs will give some margin considering the authorities' commitment to a prudent external borrowing policy.

On the risks to the outlook, it seems Senegal has good news, since the possibility of a sustained increase in global petroleum prices appears to be lessened by the relative short duration of the conflict in Iraq, and the situation in Cote d'Ivoire, which has improved relatively to that at the end of last year. However, we remain concerned that authorities have not made specific allocations in the 2003 budget to compensate for food shortages in 2003 as they do not anticipate the occurrence of such event. Unfortunately, these events happen when they are less expected and the region seems to be prone to them.

Structural Reforms

We welcome the progress made by the authorities on structural reforms. In particular, we commend them for their hard work to improve the administrative regulatory and judicial environment for private sector activity, as well as for their efforts in the fiscal area and invite them to continue strengthening the efficiency and transparency of public expenditure management.

During last Article IV consultation, the Executive Board urged the authorities to address vigorously the long-standing structural problems in the groundnut and electricity sectors as well as in the postal service, given the impact that these have on public finances. We are somewhat relieved to hear from Mr. Ondo Mañe that financial performance in SENELEC and SONACOS has improved, a point shared by the staff. However, the staff also states that, nonetheless, little headway was made in preparing reforms that would have put the energy and groundnut sectors on sound footing. We invite the authorities to follow the staff's recommendations and maintain the commitment to carry out the reforms, particularly to go on with the privatization plans and to improve transparency in this respect. We welcome the authorities' decision to consent the publication of the staff report.

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

Ms. Lundsager made the following statement:

We have watched the development of this program with great interest and we appreciate the staff's responsiveness to our inquiries over the past months. Senegal's last PRGF-supported program expired in April 2002 without conclusion of scheduled reviews because it was clear that conditions—including longstanding structural issues in the groundnut and electricity sectors—could not be met. Inefficient state-owned enterprises in these sectors continue to drain public finances and hamper economic growth. Other ongoing problem areas include poor public expenditure management (PEM) and tracking, a poor private sector business climate, and a fiscally weak pension system. Failure to follow-through on past commitments in these areas has contributed to Senegal's ongoing dependence on Fund resources—two decades as noted by Mr. Alazzaz and the IEO's prolonged user report.

The authorities have, however, taken a number of welcome incremental steps. These include the recent PEM directives, the new action plan to promote private sector activity, stronger tax collection efforts, and long-overdue steps to boost public enterprise performance. We welcome the basic strategy of their Fund-backed program, listed in paragraph 20 and described in Mr. Ondo Mañe's statement but, frankly, we have seen it before. Clear signals can demonstrate sustained commitment—Mr. Usman pointed to avoiding recourse to exceptional budgetary procedures as a high priority.

Structural Reforms

As Mr. Callaghan emphasized, Senegal's prospects are heavily linked to needed structural reforms and he raised concerns about the lack of policy definition. The proposed privatization of SONACOS is long-overdue and could bring an end to millions in subsidies and would have a positive impact on poverty reduction by improving returns to farmers.

The Energy Sector Policy plan (letter) emphasizing increased private participation in power generation is also welcome. We congratulate the authorities for publishing this plan (as well as their consent to publish the staff report). As Mr. Basu said last week at the informal country matters meeting, transparency and accountability are critical to permit public monitoring of successes and failures.

We are pleased that the authorities have agreed to share information about the Large Infrastructure Projects with the staffs of the IMF and World Bank. But the statement on page 23 (paragraph 34), which states that "some public resource involvement may be required" concerns us. We would appreciate further details from the staff on this point. Even if these projects are completed on a BOO or BOT basis, they could still represent a contingent liability for the Government of Senegal. A failed project could wipe out HIPC gains and derail private sector development. The government must avoid any explicit or implicit liability associated with these projects.

On a related point, private sector development needs a predictable, transparent regulatory and legal framework and, as Mr. Alazzaz noted, a flexible labor force. Predictability can generate private sector confidence and, importantly, help attract foreign investment. We also share Mr. Callaghan's concerns about the planned expansion of public sector employment. We would add that some further pension reform prior to this expansion—perhaps placing new hires into a modified pension system—would help alleviate FNR's long-term financial position.

HIPC

Senegal seems very unlikely to meet its Completion Point by end-2003. Social sector targets for completion point have not been adequately implemented, and in fact have gotten worse. Paragraph 14 of the MEFP mentions that an emergency action plan has been developed for the health sector, but it is difficult to see how we can expect to measure results (e.g., on prenatal care or vaccinations) between now and the end of 2003. The authorities also need to further strengthen the tracking of HIPC-related outlays. The authorities must demonstrate that HIPC resources can be used and monitored effectively in priority sectors.

Trade

We are pleased that AGOA is starting to attract investment and create jobs in Senegal (paragraph 24). U.S. investors are currently working with Senegalese partners to revitalize factories and generating new jobs.

We read on page 20, n. 13 that the authorities plan to change their export data reporting, with a likely downward adjustment in the data. Given the potential impact on the CP Debt Sustainability Analysis, it is important that this be done transparently and in line with accepted reporting practices. We request a staff assessment of this proposed change in the next staff report.

TF/AML

We recognize Senegal's efforts to search for and block the assets of terrorists, including through its cooperation with other WAEMU member states. We urge further improvements in the authorities' ability to freeze terrorist assets in order to fully implement the relevant UN Security Council Resolutions and urge the authorities to accede to and implement the International Convention for the Suppression of the Financing of Terrorism.

Other

We note that Senegal is a heavy user of IMF technical assistance. It would be useful to include some assessment of its effectiveness in the next staff report. Regarding the safeguards assessment of BCEAO in July 2001, we urge faster progress on the recommended measures. Finally, we could not agree more with Mr. Alazzaz who suggests that Senegal aim for an exit from the use of Fund resources. That would signal that Senegal has achieved sound public administration and a growing diversified, job-creating private sector. Let us hope we get there soon.

Mr. Josz made the following statement:

Boxes 1 and 2 of the staff document show that the authorities made good use of WAEMU's stability-oriented framework in restoring the growth base of their economy, which had contracted severely as a result of the CFA franc devaluation of 1994. The export sector now accounts for some 30 percent of GDP, still about 5 percent less than before the devaluation. (See Statistical Annex, Table 3, p. 6). In 2002, the growth of output lagged behind population growth due to bad weather, but Senegal's macroeconomic policy performance did not falter.

Given this expansion of Senegal's growth base and consistently adequate macroeconomic policies, it is surprising that it will take three years or more for Senegal to reach its completion point under the HIPC Initiative. But weak revenues and the neglect of overdue reforms in the electricity sector and postal service derailed the previous PRGF-supported program in 2002, and the progress with education and health care that is needed to reach the floating completion point has been very slow in this country where incomes and consumption are very unequally distributed.

The World Bank Country Assistance Strategy, and the new three-year PRGF-supported program set up in accordance with the Poverty Reduction Strategy Paper approved last year, provide a policy agenda whose consistent implementation will finally bring Senegal to its completion point later this year, while laying a strong foundation for growth and poverty reduction. The authorities must pursue structural reforms more consistently than in the past if the massive financial support obtained from Senegal's multilateral and bilateral partners is to produce real progress for the poorest members of society.

The authorities and the staff have rightly reached the conclusion that the best strategy for the next three years will be to continue strengthening the fiscal position and finish the long overdue reforms in the electricity and groundnut sectors. It is interesting that these conclusions are based on examination of Senegal's performance under past programs (see paragraph 15), a kind of examination that is now common for long-term users of Fund resources. Like Mr. Alazzaz, I would like to learn more about the causes for Senegal's inconsistent execution of structural reforms, and what remedies are being applied to prevent new slippages under the coming PRGF-supported program.

The slow progress of efforts to reduce the cost of electricity casts doubt on the prospects for success of ten large infrastructure projects now being planned. How can the authorities be so eager to create new infrastructure but so reluctant to reform their electricity sector, which is one of the costliest in region and a significant defect of Senegal's business environment? It seems more urgent to reform the electricity sector and extend its reach to rural areas, than to build a new international airport or a toll highway. The effect of all these projects on growth and poverty reduction should be carefully assessed and compared before any are approved. It is also doubtful that such ambitious projects can be fully financed on concessional terms, as required without exception under the new PRGF-supported program. I invite some clarification from the staff or Mr. Ondo Mañe. It would take only a few ill-designed infrastructure projects to erase all of Senegal's benefits from the HIPC Initiative.

Similar caution is required when implementing the medium-term recruiting strategy aimed at curing the critical short-staffing of social services, domestic security, revenue administration, and the judiciary. Thanks to the prudent hiring strategy followed during the 1990s, the wage bill is comfortably below WAEMU's convergence criterion on public sector wages. New hires are clearly needed in some sectors, especially rural health care. But staff increases should be confined to areas where needs have been clearly identified, and must be strictly bound by the program's financial constraints.

Finally, I note with interest, but also some concern, that Senegal has recently obtained a credit rating similar to those of Romania or Bulgaria. This surely bodes well for Senegal's graduation from official concessional financing, but raises concerns about Senegal's compliance with the continuous performance criterion forbidding borrowing on non-concessional terms: for Senegal to seek such a credit rating could mean that officials are thinking of contracting debt on commercial terms. The staff's comments on this point would be welcome.

Mr. Le Fort and Mr. Segura made the following statement:

We thank the staff for a highly informative and interesting report and Mr. Ondo Mañe for his insightful preliminary statement. We would like to begin by highlighting the fact, as stated by the staff, that Senegal has shown a strong track record of policies over the past few years, as well as increased ownership of the program. This is particularly important, since problems in the implementation of reforms, and what was perceived by the Board as a lack of ownership, led to the expiration of the past PRGF-supported program, on April 2002, without the conclusion of the last review. We are also pleased to notice that the completion point under the HIPC Initiative could possibly be reached by end-2003, after delays from the original schedule.

Senegal has shown an overall satisfactory macroeconomic performance over the last years: strong GDP growth rates, above 5 percent since the mid nineties, despite a temporary slowdown to 2.4 percent in 2002 due to severe weather-related drops in agricultural production; an inflation rate within international levels; a stable exchange rate and prudent monetary policy by the regional Central Bank; and a healthy fiscal performance. All WAEMU primary convergence criteria have been met, except for the nominal debt-to-GDP ratio—which could be temporarily and slightly off-track—as well as the secondary criterion for the current account deficit. Moreover, projections under the proposed program indicate that a strong macroeconomic performance is envisioned over the medium term. GDP growth rates would remain close to 6 percent, with a balanced performance among agricultural and non-agricultural sectors; private consumption, savings and investment would show a consistent upward trend; and exports would remain steadily growing, with a greater diversification of the export base favored by the advantages of the WAEMU regional market and other trade agreements. Moreover, even taking into account import growth, the trade and current account balances would remain within reasonable levels, although they should not be left unattended.

On the fiscal front, the overall balance, both including and excluding grants, would show a necessary albeit not slight deterioration due to the transitory outlays for pushing through with structural reforms. On the expenditure side, pro-poor spending would be emphasized, with an increasing share of capital expenditures aimed at improving social and infrastructure services, and full compliance with WAEMU's expenditure management directives would be attained. It is also worth noting that the wage bill has been consistently falling over the last years, even though, as Mr. Ondo Mañe indicates, it is now expected to grow due to the necessary hiring of staff to implement the PRSP goals in the education and health sectors. Regarding capital expenditures, as the staff points out, it is imperative that large infrastructure projects under the APIX agenda are developed by the private sector, following adequate feasibility studies. Also, we are pleased to notice Mr. Ondo Mañe's remarks that the latter would be financed through BOOTs and BOOs. On the revenue side, we welcome the authorities' plans to enhance and modernize revenue collection, as well as to broaden the tax base with measures such as the synthetic tax for SMEs, in an effort to pull them away from informality. Nonetheless, we advise the authorities to design contingent offsetting measures, if, as the staff points out, revenues fall behind target, or disbursements of budget grants from EU do not materialize due to delays in the implementation of reforms. If this scenario were to take place, spending cuts would also have to be considered to avoid a further widening of the fiscal gap. We are encouraged by the fact that financing needs during the period of the proposed program are expected to be covered without major problems; and that domestic and external public debts, as well as their service ratios as a share of GDP and of exports, would register a decreasing path following an eventual HIPC completion point by end 2003.

This said, we consider that the main challenge lying ahead for the Senegalese authorities, in which they have only had mixed results in the past, is the implementation of the structural reform agenda, comprising but not limited to the electricity and groundnut sectors, expenditure management aimed at a more efficient pro-poor spending, and promotion of private sector development and activity. Pushing forward unfalteringly with this agenda is the only way to achieve better infrastructure and social services, especially in rural areas, in order to bridge the acute urban-rural differences, improve health indicators, and reduce the lag in primary enrollment, illiteracy, and access to water indicators relative to the Sub-Saharan African mean. In this regard, we are encouraged by the fact that the authorities have launched their Poverty Reduction Strategy in 2003, aiming at halving poverty by 2015, and concentrating efforts on the rural economy as well as on SMEs. We also remain confident that as the PRSP is implemented, more specificity regarding policy targets, sequencing, and instruments, will be delivered.

In sum, we share the staff's view that the Senegalese authorities have put together a consistent program, comprising prudent macroeconomic policies and a well-crafted structural reform agenda, which combined with their strong track record and prior actions compliance, attests to the increased ownership of the program. For these reasons, we support the recommendation to grant Senegal a new three-year PRGF arrangement, as well as additional interim assistance under the enhanced HIPC Initiative until end-2003. We also agree that the next Article IV consultation can be held within the 24-month cycle. We look forward to the discussion regarding the completion point, and hope that all requirements can be met in time, so it can take place within the envisioned schedule. Finally, we wish the authorities every success in the challenges lying ahead.

Mr. Moser made the following statement:

Senegal is a country with an enormous potential. Macroeconomic stability has helped maintain the gains in competitiveness derived from the devaluation in the mid-1990s, and the sector that has been forcefully liberalized, the telecommunication sector, is one of the most competitive in the subregion. The report on Senegal's productivity growth recently released by the Ministry of Economy and Finances specifies the continuing obstacles to higher productivity growth, most of which are also mentioned in the staff report.

Even though the requested program is not as strong as we had hoped for, we are ready to support the requests for a new PRGF-supported program and for additional interim assistance under the enhanced HIPC Initiative.

The program is based on growth assumptions, however, which will probably prove too optimistic. Even so the numerous donor-supported infrastructure projects should give a short-term boost; we missed a proper underpinning of the projected 6.6 percent GDP growth for 2003, which is substantially above recent private sector forecasts and well above the historical average.

We share the concerns raised by Mr. Callaghan that the pursuit of increased growth through expanding social and infrastructure services may compromise macroeconomic stability. The program envisages a substantial loosening of the fiscal stance, which takes the fiscal deficit excluding grants well above its historical average, and only one third of this increase seems to be due to additional HIPC Initiative expenditures. It is also regrettable that these additional HIPC-related expenditures are only specified in a mid-2003 supplementary budget. Given that expenditure control is a problem, the envisaged increase in capital expenditures is a challenge. We also wonder whether the envisaged decline in the wage bill can be achieved, given the government's medium-term recruitment strategy. On the revenue side, we agree with Mr. Callaghan that the scope of improvement under the program appears modest. Finally, we would appreciate it if staff could comment on the status and the impact of the envisaged fiscal decentralization.

One consequence of the looser fiscal stance is a worsening of the balance of payments. Here, we share Mr. Oyarzábal and Mr. Calderón-Colin's view that the level of the current account deficit is on the high side.

Regarding structural reforms, we think that conditionality is somewhat weak. Here again, we share Mr. Callaghan's concerns that many of the proposed structural policies—particularly in reforming SENELEC and SONACOS—are not defined. Reforming the electricity sector would go a long way in increasing productivity growth in Senegal, apart from having substantial beneficial effects for public finance and for the population. We thus welcome the government's intention to expand capacity through private independent power producers and to privatize SENELEC by end-2004. As to the groundnut sector, we miss indications of a broader policy agenda in this important sector. Finally, as mentioned on earlier occasions, we would have liked to see some structural conditionality in the area of expenditure control and budget execution. Given the weak tracking of HIPC Initiative-related expenditures, we join Mr. Usman in urging the authorities to implement more forcefully staff recommendations in this area.

Among the main obstacles in attracting much-needed foreign direct investments continue to be problems in governance, particularly corruption and a weak legal and judicial system. We thus regret that the staff report does not deal with this issue more in depth. However, we welcome the establishment of the governance surveillance commission mentioned in the Memorandum on Economic and Financial Policies and urge the authorities to quickly tackle these very delicate issues.

We have some concerns regarding the fact that the President's Large Infrastructure Projects are not covered by conditionality. As noted by the staff, such large projects run the risk of being nonviable and becoming a long-term burden for public finances. A proper cost-benefit analysis, together with the consideration of alternative projects, is thus crucial for the long-term success of such investments. Private sector participation and management should be sought for and must be promoted. If a participation of public funds is needed, these amounts have to be included in the budget and need to be consistent with the long-term fiscal framework. Utmost transparency and full consultation with the Fund and Bank staff is important.

I also have to note that, like Ms. Lundsager, we do not believe that it is realistic to expect Senegal to reach the HIPC completion point by the end of 2003. Health indicators have deteriorated, and education indicators have hardly improved. Progress in these areas would desperately be needed. Illiteracy, for instance, is almost twice as high as in other Sub-Saharan African countries. In our view, it is important that Senegal will meet the triggers for reaching the completion point in these areas, given that the triggers were not overly ambitious and that waiving these poverty-reducing triggers would hamper the credibility of the HIPC initiative. Given past performance, we would also like a see a longer track record.

Finally, we welcome the authorities' intention to publish the staff report.

Mr. Duquesne made the following statement:

Let me first join other Directors in thanking the staff for a well-balanced report, and Mr. Ondo Mañe for his comprehensive and helpful preliminary statement. We were glad that a continuous dialogue between the authorities and staff resulted in the definition of this new program. We are confident that this program, combined with the World Bank's Country Assistance Strategy approved earlier this month, will assist the authorities in their efforts to address Senegal's major constraints to growth, maintain sound policies, and make effective progress in reducing poverty.

As pointed out during the Bank's Board discussion and today's discussion, strong and sustained implementation of the program will be key to achieving these objectives. Equally important is to ensure that the authorities and all development partners and stakeholders work in a coordinated manner so that all their efforts effectively converge toward the objectives of the PRSP. This means coordination within the administration, including the authorities at the highest level, the executive agencies, and governmental institutions, as well as coordination among donors so as to ensure complementarity of their respective assistance programs.

Turning now to Senegal's performance under the Fund-supported program, we concur with the thrust of the staff appraisal. On the fiscal front, public finances were strengthened in 2001 and 2002, resulting in a basic fiscal surplus as a result of commendable efforts to increase fiscal revenue and to contain nonpriority expenditures, including financial assistance to a number of public enterprises. These efforts are particularly important and welcome in the context of the elimination of the central bank's advances to WAEMU countries, which has been enforced since end-December last year.

We also welcome the adoption of the three pending WAEMU directives on public financial management. We are particularly pleased to see that these directives were included in the program's framework as prior actions. As this chair stated during the discussion on WAEMU's recent developments, we believe it is important that the Fund support regional integration not only under its surveillance exercise but also at the country level, by including this type of measures in the Fund's program design.

On the structural front, we are encouraged by the fact that the authorities recognize the strong link between consistency in reform implementation and investor confidence. We thus welcome the adoption of the Letter of Energy Sector Policy, and look forward to further improvements in competitiveness in the energy sector through enhanced private participation, since deficiency in power generation and distribution remains a major bottleneck to growth.

On the groundnut sector, while SONACOS' financial position has strengthened and remains satisfactory despite last season's poor groundnut harvest, it is important to take the appropriate steps to improve the sector's competitiveness and resilience to shocks, especially given its impact on the rural poor.

We look forward to the completion of the PSIA and further studies to be conducted under the guidance of the Bank. Progress in this field is key to addressing the urban-rural divide, and this very important area is also central to the Bank's assistance strategy and will remain under close scrutiny by the donor community. Also key to fostering growth in all segments of the economy is better access to finance, particularly to the banking system, which remains sound by regional standards. Needless to say, efforts to strengthen transparency, promote good governance, and fight corruption should also be sustained.

On the large infrastructural projects, I take note in Mr. Ondo Mañe's statement of the authorities' clear intention to consult with the Fund and the World Bank in order to assess the viability and the potential impact on the budget of each project. I welcome, of course, that intention. Like

Mr. Callaghan, I would also emphasize the importance of ensuring full transparency in project preparation and implementation, and undertaking adequate due diligence to assess whether these projects are compatible and consistent with the program's framework as well as with the PRSP's objectives. So, that might be an answer to Mr. Moser's concern.

Finally, I encourage the authorities to maintain a prudent external debt policy in light of the country's vulnerability to external shocks. I am confident that sustained implementation of the Bank and Fund programs will allow Senegal to reach its completion point as scheduled before the end of this year. In this prospect, I note that Paris Club creditors provided financial assurances to this program by extending the 2000 debt repayments until the end of December this year.

In conclusion, we support the proposed decisions. We hope that, with the continued support and guidance of the Bank and the Fund, the authorities will be able to put their country on the path to sustained growth and poverty alleviation, and we wish them every success in addressing the many challenges ahead.

The staff representative from the African Department (Ms. Schmitz), responding to questions and comments from Executive Directors, made the following statement:

I would like to start with the topic of program design and ownership, which has been referred to in several preliminary statements and also in statements this morning. Basically, the underlying question is what is different, if anything, with this program so that the probability of derailment is lower than under past programs. In this context, one preliminary statement wonders about the implications of the policy option paper for the program design, and I would like to explain that the policy option paper was a vehicle for Fund staff to think through issues involved in the design of the program, taking into account lessons from the past. The goal was to better understand what type of program in terms of scope and reform composition would best support the PRSP strategy. This process of reflection also involved our colleagues from the World Bank, and we specifically examined the following aspects: the scope of the program under alternative strategies and its implications for the start of the program and for the reliance on technical and financial input from donors. Related to the scope and the elements of these alternative programs, the staff explored the following points: evidence of ownership and commitment, political and technical considerations for the sequencing of reforms, and risk of slippages under a new program.

The purpose of this exercise was for us to gain a better understanding on mainly two issues: first, Senegal's technical and political capacity to proceed with reforms; and, second, the extent of the Fund's involvement in this effort under a PRGF arrangement. Neither specific macroeconomic scenarios nor an exit strategy were focal points of this exercise. However, we have discussed the notion of exit with the authorities, and both the government and the staff expect that Senegal could graduate from exceptional financial assistance at the end of the proposed program period provided the program is vigorously implemented.

The authorities have stressed, however, that they value the signaling role of Fund programs to foreign investors, creditors, and domestic political constituencies. Moreover, as the staff report has noted, Senegal remains vulnerable to severe external shocks. Thus, there may remain a possible role for Fund financial assistance in Senegal beyond the current program.

Turning now to the issue of ownership and program design, we do believe that the design of the current program has drawn lessons from past program experiences, in particular the prolonged user study. We have paid attention to ownership, risks and realism of program assumptions. This is Senegal's first program that is grounded on the PRSP both in design and in implementation, which should ensure medium-term consistency of the program with broader policy goals and adequate ownership. In addition, the government clearly took over the process of preparation of the program, as we have documented in paragraphs 16 and 20 of the staff report.

Other evidence is the fact that the authorities took the lead in deciding on the scope of the program and also in selecting the macroeconomic scenario that would be consistent with the program. They drafted themselves the economic memorandum, and they selected points of conditionality from a menu proposed by the staff. To ensure ownership, in particular, the government tries to involve stakeholders and the broad public in the process of deciding on the best concrete actions for fleshing out reforms in the electricity and the groundnut sectors. For instance, the government called a town hall meeting in March, where it presented for discussion the draft energy policy letter. It has been working with stakeholders in the groundnut sector in defining the reform strategy, and it also held a public seminar on issues related to the reform of this sector in April. Similarly, in the case of agricultural reform, the government is regularly consulting with interested donors.

We have also tried to address in a systematic way risks to the program objectives and policies for instigating these risks. We have specifically discussed, for example, the risks of sharp increases in oil prices for SENELEC's financial situation and indirectly for the budget, and tried to incorporate this into the program. We have dealt with the risk of a shortage of groundnut seeds and its impact on economic development, as well as on SONACOS's financial situation and the reform of the groundnut sector. The risk of food shortages has been taken into account, as well as the risk of asset stripping during the privatization process of SONACOS. We have also discussed risks related to political developments in Côte d'Ivoire.

Finally, I believe that the capacity of the government to implement policies has been carefully assessed, as well as the commitment of donors to support this process with technical assistance and aid. Admittedly, it is always a difficult judgment call to strike a balance between ownership and sufficient progress on the path to reaching reform policy goals. On the one hand, without sufficient ownership, there is no sustained reform progress. On the other hand, if ownership results in setting the bar for progress low, then there is probably adjustment frustration because the process stretches over a long period. In addition, the government may encounter disappointment with reform outcomes if economic agents do not perceive the reform agenda as convincing and, therefore, do not invest and react as assumed in the program. It seems that this new program constitutes the best joint judgment of the authorities and the staff on achieving a balance between these two aspects.

Let me turn now to technical program issues raised. One concern raised in a preliminary statement was about the external current account deficit relative to the ceiling suggested by WAEMU. The staff and the authorities have not been concerned about the level of the external current account deficit as the macro path is consistent with external debt sustainability and as Senegal has commitments from donors to provide concessional financing in support of its PRSP strategy, which is reflected in this current account scenario.

There was also a query about the revision of export data. New or better information on exports has become available from other sources, allowing a better assessment of the level of exports in the context of deriving the new national accounts presentation. There is an expert group who worked on the national accounts, joining the efforts of the BCEAO to reconcile data from these types of sources. In the coming months, they probably will arrive at a joint assessment of what is the best estimate of Senegal's exports, and we will report to the Board on this issue.

There were concerns about the hiring strategy. Some of these concerns may be alleviated if one takes into account the fact that the staff has discussed guideposts for the definition of the hiring strategy with the government. The staff has also provided the government with a list of criteria to use in assessing staffing needs and constraints in meeting these needs. World Bank staff is following up closely and can bring to the table detailed knowledge from sector projects. Finally, an understanding on the hiring strategy and its implementation is a criterion for concluding the first review of the program, and there would be the option of introducing conditionality for the further part of the program in this regard.

There were questions regarding the presidential large infrastructure projects, in particular, how to protect the program goals. First, I would need to clarify that neither the government nor potential private sponsors of these large infrastructure projects have yet formulated concrete plans. The most advanced are, if at all, ideas on a new international airport and highway. The authorities have so far shared with the Bank and Fund staffs all the available information on these projects, and there has been a longstanding dialogue over the years on this issue in principle.

To be more specific, to illustrate what we know and what the situation is, I can elaborate on the airport. There is a preliminary feasibility study that was completed in December by an international company. That study arrived at a cost estimate equivalent to 3.8 percent of annual GDP. These costs would obviously be spread over several years. The study seems to be based on rather realistic assumptions. However, it is incomplete and, therefore, it is impossible to assess the project's viability, or to assess the implications for the economy and public finances at this stage. Key elements are still missing, and among them is a detailed financing plan. Also missing are sector policy frameworks that directly concern the airport project, for instance, a regional development plan for Dakar, a tourism sector strategy, and government plans for using the space occupied by the current airport. The government plans to work on all these issues in the coming months, including the question of a road connection to the new airport and a new law for awarding concessions of a BOT-type nature. Currently, all concerned ministries are examining this preliminary study, and the government will keep the Bank and Fund staff updated on its work; this is clearly spelled out in detail in paragraph 34 of the economic memorandum. At the end of this consultation progress, when all parties have had the opportunity to assess the viability and the macroeconomic impact, then the judgment has to be made whether these projects are coherent with the program goals.

So, as I see it, the bottom line is that the staff's role is in advising the government against launching nonviable large infrastructure projects. I see our role in working closely with the government on incorporating viable ones into the macro framework in an adequate manner, and that may require compromises in terms of the phasing and features of the projects.

There were still two questions in the area of public finances. First, on decentralization, there are several donors, including the World Bank, who are supporting the central government in this regard. The focus of their efforts at this time is on assessing and improving budget and service delivery performance of local governments, which is mainly directed toward health and education. There are no imminent plans to decentralize expenditure at this stage. The idea is to wait to be sure that the capacity is available at the local level to handle this delegation of expenditure efficiently.

Second, there were some concerns that the staff report did not elaborate sufficiently on how to address governance issues. I would just

> quickly like to summarize elements that deal with governance in the program. There is now the Council on Good Governance. The idea was borne in the Presidential Investors Council. Second, there is clearly a comprehensive program in place to enhance transparency and controllability of public expenditure, which is also supported by the World Bank and the European Union. Third, there have already been public expenditure reforms, such as a now procurement code, and the World Bank is reviewing again the implementation and practices under this code. Fourth, decisions have been made to simplify administrative procedures for private investment and review of land purchase regulations and administration. Fifth, the investment code will be reformed to make it more transparent. Sixth, there will be BOT laws and information sharing on the large infrastructure projects, on which the government clearly agreed. Lastly, the privatization of SONACOS and SENELEC should also alleviate governance concerns. Looking forward, the government is working on defining a broad program for judicial reform.

Mr. Josz thanked the staff for the answers and asked why Senegal, which was not supposed to borrow on non-concessional terms, had a credit rating which presumably was intended for bond issuance. As Senegal's external debt sustainability remained a concern, the country should not contract non-concessional borrowing.

The Deputy Director of the Policy Development and Review Department (Mr. Allen) replied that a number of African countries had tried to obtain credit ratings, but that did not necessarily mean that the sovereign planned to borrow in capital markets. Establishing a sovereign credit ceiling could benefit the private sector and the banking system in the country as it made explicit the limit on the ratings that private sector borrowers could obtain. To his knowledge, the Senegalese authorities had currently no plan to engage in commercial borrowing, and the ceiling on the contracting or guaranteeing of new non-concessional external debt was, in fact, a continuous performance criterion. Some of these issues might be discussed in a paper on debt sustainability in low-income countries, which was scheduled for circulation to the Board in May 2003.

Mr. Brooke made the following statement:

> Senegal's macroeconomic performance in the last several years has, on the whole, been good. However, as other Directors and the IEO have identified, structural reform implementation and program ownership have been much weaker. It is for this reason, together with misreporting, that Senegal has not yet reached its HIPC Completion Point. Consequently, the authorities still face a significant structural reform agenda.
>
> Only by making progress in the areas identified in the staff report (which we strongly support) will Senegal achieve the aims outlined in its PRSP and realise higher and sustainable levels of growth together with meaningful poverty reduction.

We broadly agree with the proposed PRGF-supported program and with staff's appraisal of it and have only a few points to add.

First, reflecting past problems of implementation, we are pleased to see that the Senegalese Authorities have taken note of the Board's call for a more realistic framework which focuses and prioritises on fewer goals. We also welcome Mrs. Schmitz's indications of improved ownership. The key to keeping the program on track and reaching the HIPC Completion Point will be appropriate sequencing of reforms, a manageable agenda and strong efforts to maintain public support for the reforms. In this regard, we welcome the increased emphasis on public monitoring of, and regular reporting on, PRSP implementation.

Second, we urge the Government to deliver its proposed program to increase the transparency, efficiency and control of public expenditure management and monitoring. Consequently, we are pleased to note the Government's request for a ROSC on fiscal transparency.

Third, as Ms. Lundsager and Mr. Josz have outlined, the Government needs to act decisively in restructuring and privatising inefficient public enterprises which have proved to be such a drain on its budget and diverted resources away from key priority sectors. We urge the authorities to demonstrate stronger ownership of their reform agenda in this area and to implement the outlined measures in the electricity, groundnut and postal sectors as quickly as possible. Without such reforms, the high cost of production will remain a problem in Senegal and will continue to depress growth and living conditions for the poor.

Fourth, we share the reservations of Ms. Lundsager, Mr. Callaghan, Mr. Moser and Mr. Josz about the authorities' planned medium-term recruitment strategy and large infrastructure projects. As staff note, these plans should be carefully designed, to be financially and technically viable. They should be undertaken in a transparent manner, and comply with best practice on governance arrangements. We welcome Mrs. Schmitz's comments in this regard.

And, finally, I have two questions. First, given the sharp slowdown in spending in 2002, how confident are Staff that the economy will rebound to 6.6 percent growth this year and thus sustain spending of around 6 percent over the medium-term? We feel the main risk here is, once again, the pace of structural reform implementation.

Second, we welcome the fact that the Fund has recruited a consultant to undertake the first-phase of a PSIA into reform of the groundnut sector, with the Government and WB carrying out the second phase. Given the importance of building and maintaining support for the reforms, has the Fund proposed a further program of PSIAs for other reform areas? If so, what aspects and when are the results likely to be available?

Finally, in response to the comments by a few other Directors, we think it is too early to say at this time when the HIPC Completion Point will be reached. However, the clear message from this Board today is of the need for strong program implementation in order to establish the necessary track record.

We support the proposed program.

Mr. Komatsuzaki made the following statement:

In the last decade, Senegal achieved a moderately high growth and made a slow but steady progress in poverty reduction. Poverty is still prevalent, however, and structural problems have to be tackled more vigorously to achieve a higher growth. The Fund has an important role for policy advice. This chair broadly concurs with the staff appraisal and agrees with the proposed decisions, but would like to make some remarks.

Overall strategy of the program appears generally appropriate. We agree with the strategy to implement a manageable agenda of not too many but far-reaching reforms. The realistic targets in the baseline scenario are welcome as well. One area that might warrant more attention is exit strategy, but we appreciate Mrs. Schmitz's comment on this point. We urge staff awareness on this point in the future reports.

The authorities should be commended for their prudent conduct of fiscal management. They need to maintain this stance. In this context, we welcome the consistency of the medium-term macroeconomic framework with the more prudent scenarios of the PRSP. Future broadening of the program should be allowed if and only if reforms advance more than the current assumptions and capacity for expenditure management improves, so that there is assurance that an additional expenditure is going to be used effectively. We must say that the Presidential Large Infrastructure Projects appear to be at odds with the authorities' otherwise prudent fiscal stance. As we understand that there is no concrete plan yet, we would stress the necessity of extensive consultation with the Fund and the Bank, and cost benefit analysis at this point.

Persistent structural problems have prevented Senegal from achieving higher growth and making faster progress in poverty reduction. Indeed, the stop-and-go policy implementation in structural reforms is pointed out as one of the reasons for prolonged use of Fund resources by Senegal. We appreciate the fairly detailed description on structural problems in the staff paper. Reform of the public enterprises, in particular, requires faster progress. It appears, however, that the authorities are yet to find viable solutions for many of the public enterprises. In light of the past difficulties in managing them and current unfavorable environment, a clear viable strategy under conservative assumptions has to be found for those enterprises. Delay in the resolution of these public enterprises would also risk fiscal position, as pointed out by a number of directors. More generally, environment for private sector activities has to be improved, and we welcome the determination of the authorities. Few actions have been taken so far, however, as a Letter of Private Sector Development Policy has just been prepared. This area needs continued attention in the future staff reports.

With these remarks, we wish the authorities every success.

Ms. Gust made the following statement:

We can support the request for a three-year PRGF arrangement and additional interim assistance under the enhanced HIPC Initiative. Given that I agree with many of the points already made in the preliminary statements of Mr. Mirakhor, Mr. Callaghan, and Mr. Alazzaz, and essentially all of the speakers preceding me, on fiscal policy, presidential large infrastructure projects, debt management, the creation of an enabling environment for private sector development, the need for an exit strategy from the use of Fund resources, and also the timing and sequencing of the proposed reforms, I can keep my comments quite brief and would like to focus on only a few issues for emphasis.

Notwithstanding the comments of Mr. Brooke on the possible prematurity of discussing the completion point, my first point is actually on the potential timing for the completion point under the HIPC Initiative. Both Mr. Ondo Mañe and the staff consider that the completion point could be reached in late 2003 provided sufficient progress is made in health and education services, and a successful six-month track record is established under the proposed program. We very much support the idea of moving quickly to completion points when the conditions are in place, and in this respect, we would certainly be willing to consider a decision in six months. However, given past performance under the previous PRGF-supported program, we would expect not only flawlessly impeccable implementation of the PRGF-supported program, but also the completion point conditions would need to be substantively met.

Given the uneven implementation of the last program and the amount of time it took to come to the point of requesting a new program, one wonders whether a longer-than-usual track record would be desirable before reaching the completion point. It is important to bear in mind that this late-2003 date represents a goal, not a presumed date for approval. If more time were needed to meet all the completion point triggers, more time should be taken. This would be far preferable to the alternative of being faced with the possibility of multiple waivers on the triggers; I believe Mr. Moser made this point as well.

To that end, we propose that the completion point not be reached until after the first review of the PRGF-supported program has been approved. At the time of the review, the staff should provide information on the progress toward reaching the completion point, and Directors could provide guidance as to whether it will be desirable to go forward with the completion point shortly after the review, or whether more time would be needed.

This leads me to my second point, the need for the authorities to translate words into deeds. Given that the last PRGF-supported program expired without the final review, in part because of problems with the implementation of some reforms, we welcome the recent momentum observed in the authorities' preparation for further structural reforms. The authorities deserve to be commended for their recognition that the major challenge ahead is sustaining this momentum for implementing a comprehensive reform agenda that would trigger strong, broad-based economic growth. Improving the administrative, regulatory, and judicial environment will be needed to encourage private sector activity. Strengthening public expenditure management and tracking will also be essential.

My last point is related to the previous points, and that is the importance of ownership. It seems clear from the staff report and Mr. Ondo Mañe's preliminary statement that it appears as though the authorities have strengthened their ownership of the necessary reforms proposed by the staff over the years. We are pleased by the authorities' steps to date to institute public monitoring of PRSP implementation, continued implementation of the FSAP recommendations and, as noted by Mr. Brooke, completion of the preparatory questionnaire for a ROSC on fiscal transparency. Plans for the future to not only give the PRGF-supported program a high public profile, but also strengthen public expenditure management—an area highlighted as being weak in the past—strengthen governance, and undertake a poverty and social impact analysis on the groundnut sector are welcome. I support Mr. Brooke's comments on whether there are any plans to do PSIAs in other sectors as well.

The information provided by Ms. Schmitz on the staff's assessment of ownership and its implications for program design was excellent, comprehensive, and extremely useful and very much appreciated. I think this is exactly the sort of information that Directors are looking for when they are asking for an assessment of ownership, and I would certainly encourage the staff to provide this sort of information in other program documents, especially on the initial request for a Fund-supported program.

Let me commend the authorities for their decision to publish the report, and wish them every success in the future.

Mr. Maciá made the following statement:

In the 1990s, under policies that enhanced broad-base growth, Senegal experienced a strong economic performance. In 2002 growth was hampered by severe climatic conditions, though inflation was significantly curtailed. Even in face of weak terms of trade, the external current account deficit tapered somewhat assisted by strong mining exports, a rise in tourism revenues, and a holdback on imports.

Public finances in 2002 showed a slightly larger than projected surplus despite slower economic growth. While fiscal consolidation was in part responsible for this better-than-expected fiscal outturn, lower-than-programmed HIPC-related spending was also a factor. The combination of a moderate fiscal surplus and a prudent monetary policy stance have supported the exchange rate peg and kept inflation at bay.

The banking system's risk concentration limits domestic credit choices and large enterprises resort to their foreign affiliates for funds. This structural issue needs to be addressed. Transparency and control were enhanced with the reforms to the procurement code, expenditure management, and the budget classification system. The action plan to assist private sector involvement, the committees to reform the electricity and groundnut sectors, and reforms to pensions, the judiciary, and the postal system must be pressed forward diligently.

The authorities are committed to pursue a vast poverty reduction agenda in the medium term in face of a strong macroeconomic framework. A growth rebound is expected, inflation is to remain well under control, and the external current account deficit will temporarily carry the weight of higher food imports and lower exports reflecting last year's climatic shock. Priority sectors' investments should surge under the PRSP strategy and HIPC-related projects. Infrastructure projects are crucial to reduce production factor costs. To improve the private sector investment environment measures will be required in taxation, the regulatory environment, the judiciary, and the investment code update. The medium term foresees the recovery of agricultural exports and terms of trade. Senegal should pursue further regional integration, the use of the U.S. African Growth and Opportunity Act, and enhance the ongoing investment trend into export capacity and diversification to maximize its overseas earning potential.

The fiscal outlook in the medium term is expected to improve as revenue measures are consolidated though the overall fiscal balance for 2003 portrays a deficit. This gap is expected to be financed through concessional loans for projects, debt relief, and exceptional financing from multilateral institutions (WB, IMF, ADB). Also, the authorities will focus on tax and customs administration, broadening the tax base, information technology to enhance enforcement, integrate small businesses and informal sector activities into the tax scheme, and pursue the pending corporate tax reform. On the expenditure side, key sectors' outlays are to target rural infrastructure, boost domestic and foreign-financed capital spending, and cover impending reform costs. Expenditure management is to strengthen budget and treasury operations, and improve the tracking system of key sector spending.

We support the request for a new three-year PRGF arrangement, and the extension of additional interim assistance under the HIPC Initiative. We commend the authorities for their strong ownership on reforms, wish them success, and look forward for the HIPC completion point during the present year.

Mr. von Kleist made the following statement:

We thank the staff for an informative set of papers and Mr. Ondo Mañe for his helpful preliminary statement.

As the staff report points out, economic developments in Senegal in 2002 were mixed. Real GDP growth in Senegal amounted to 2.4 percent, which is less than the population growth of previous years. On a per capita basis, Senegal is therefore backsliding. On the positive side, inflation remained subdued. Moreover, the Senegalese authorities have to be commended for strengthening public finances through tight aggregate expenditure control and higher tax revenue. On the structural side, however, very much remains to be done.

Since we agree with the thrust of the Staff appraisal and since previous speakers, especially Ms. Lundsager, Mr. Moser and Mr. Brooks expressed many of the concerns which I share, I will limit myself to six remarks.

Firstly, I would like to reiterate a point that this chair has already made during our discussion of the Senegalese PRSP last December, namely that sustained growth cannot be achieved without further improving the climate for private investment. This in turn requires, among other things, the removal of administrative, regulatory and judicial impediments as well as further progress in fighting corruption.

Secondly, since the last PRGF-supported program expired without the conclusion of the final review, we urge the Senegalese authorities to comply fully with the conditionality under the new program. We also encourage them to observe both the primary and secondary WAEMU convergence criteria as they are a good complement to the Fund's conditionality.

Thirdly, we remain concerned about the absorptive capacity of the public sector. We therefore urge the Senegalese authorities to improve this capacity in order to assure that PRGF and bilateral donor resources will used for poverty-reducing projects and that these projects are implemented in a cost-effective way.

Fourthly, let me comment shortly on the issue of certain large infrastructure projects envisaged in Senegal for the not too distant future. Senegal is and remains a HIPC. It is hard to understand what the specific contributions of these project to fighting poverty will be. There surely are more pressing needs in Senegal, or other projects that compare more favorably in a cost/benefit analysis, with less risk concerning their viability. It is a well-known fact that the health care system badly needs investment, in particular in rural Senegal, to reach the millenium development goals. Also, as other speakers have mentioned, Senegal trails other countries in education goals. Health and education are probably the best long-term sources of growth for any country. The fact that a substitute for the sunk ferry boat "Joola", a vital infrastructure link has not been acquired, months after this tragic accident, does not point to strong administrative capacities, and this in turn does not bode well for less needed capital intensive long-term prestige objects such as the airport and the costly infrastructure necessary for travellers to be able to reach the airport. Given Senegal's track record on governance, full transparency of every step of the decision, procurement and building process needs to be maintained, if the government should decide to press ahead with those large infrastructure projects. I do hope that the long believed to be extinct species of "White Elephants" does not experience a resurrection in the Senegal.

Fifthly, and related to the previous point, we encourage the Senegalese authorities to further improve the coordination with and among donors in order to enhance the efficiency of development aid.

Sixth, I share the gist of the remarks of Mr. Brooke and especially Ms. Gust on the completion point.

With these remarks we support the proposed decisions and wish the Senegalese authorities every success in their future endeavors.

Mr. Lombardi made the following statement:

We thank the staff for providing us with further clarification, and Mr. Ondo Mañe for his informative preliminary statement. We support the authorities' request for a PRGF arrangement, though we share most of the remarks and concerns expressed by Ms. Lundsager, Mr. Brooke, Ms. Gust, and Mr. von Kleist, with whom we would like to be associated. In particular on the issue of reaching the completion point by the end of this year, we would like to point out that program implementation is of key importance, as Mr. Brooke has also pointed out. It is thus premature at this stage to envisage reaching the completion point at such an early stage. The six-month PRGF requirement is, in this regard, only a minimum requirement.

The staff representative from the African Department (Ms. Schmitz), in response to further questions and comments, made the following statement:

A question was raised whether the staff believes the growth projection for 2003 still remains attainable. So far, the information suggests so, and one needs to bear in mind that basically the growth rate is driven by some normalization of agricultural output, whereas nonagricultural GDP is forecast to grow by 5.7 percent, which is close to past years' records.

On the question of whether the medium-term projections on growth are prudent, as shown in Table 4 of the staff report, there are certain high growth sectors, which are those where recent investment in capacity expansion has already taken place or is occurring, and where we know there are good prospects for demand to materialize and where constraints have been lifted. These sectors are, for instance, cement, phosphates, related chemical products, electricity, construction, tourism, telecommunications, and related services. These sectors would be growing between 5.6 and 5.8 percent over the next five years, on average. We are forecasting slightly lower growth for another group of sectors, between 5 and 5½ percent, where prospects for demand may be less certain and where there are still constraints or where it is simply the type of activity that suggests lower growth. Those would be transportation, agriculture—where obstacles remain—and general industry. The staff has also been rather conservative on FDI projections.

For the third category of subsectors that determine growth, their growth remains below 5 percent on average over the next five years. Those are sectors where one does not expect major productivity gains, because of the nature of activity, for instance, commerce or government services. There are others that face constraints either of an environmental nature or other sorts, which would be livestock, forestry, fisheries, public administration, and oil milling. It is unlikely that the processing of groundnuts will reach very high levels in the near future.

On PSIA, there are two additional topics under consideration. One is rural electrification and, further down the road of the program, fiscal decentralization.

Mr. Ondo Mañe made the following concluding statement:

First of all, Mr. Chairman, I think this is your last Board discussion on Senegal. Let me, for the record, express my authorities' appreciation for your dedication to the Senegalese program. This said, I would like to thank my colleagues for their useful comments and advice, and I will convey them to my authorities. I would also like to thank the staff for their comprehensive answers to questions raised by Directors.

It is important to note that, building on past experience, my authorities have had a strong and sustained track record over the past year. They are committed to continuing to implement prudent economic and financial policies. My authorities have also completed two prior actions, the Letter of Energy Sector Policy and the adoption of the three pending WAEMU directives on public financial management. These achievements are testimony of their strong commitment and ownership of reforms. Also, my Senegalese authorities are committed to pursuing the adjustment and poverty reduction efforts. They hope that they can continue to rely on additional predictable and timely financial and technical assistance from the international community.

In line with your advice and comments, I can assure you that my authorities will continue to adhere to a cautious fiscal stance to achieve fiscal sustainability. Accordingly, the 2002 budget will be aligned with the objectives of the PRGF and the PRSP. In this context, my authorities intend to further strengthen their capacity to mobilize revenue and improve public expenditure management while increasing public expenditure in poverty-related areas in line with the PRSP objectives. They are also requesting a Fund mission to prepare a ROSC on fiscal transparency.

On the financial sector, my authorities will continue to strengthen, and eliminate all the obstacles in the banking sector, particularly in the area of credit access. They will promote development of sound macro finance and enhance access to credit for most businesses and the rural population.

With regard to the structural reform area, I would like to assure you that my authorities have committed to accelerating the privatization of SONACOS and SENELEC, the electricity company. Nevertheless, it has also been noted that the restructuring of the groundnut sector is a long process and will require consensus-building among participants, who represent two-thirds of the population of Senegal. I would also like to assure Directors of my authorities' intention to promote an economy led by the private sector. For that reason, the Investment Council was created, and recently the authorities have issued a letter of private sector development policy prepared with the assistance of the World Bank, and intend to speed up the implementation of measures to stimulate private sector investment and enhance competitiveness of the economy.

I noted the concern by Directors on the presidential large infrastructure projects. Let me say some words on that. We think that, as we negotiated with the staff at the highest level, the concern can be avoided, because the authorities have committed to working and consulting with the staffs of the World Bank and the IMF on this issue. There was a long discussion on that, and the authorities have given all the needed information to the staffs of the IMF and the World Bank, and are committed to discussing with them on the needed measures that have to be taken.

We recognize that the presidential large infrastructure projects represent 3.8 percent of GDP. My authorities are doing all that is possible and putting in these projects all efforts to attract more foreign direct investment, and address the urban and rural economic divide. The authorities are also determined to maintain, in this context, the macroeconomic framework. So, with regular consultation with the staff, I think we can avoid all misunderstanding about this engagement. Also, one should recognize that Senegal has the right to hope for this kind of infrastructure. They think, for instance, that these large projects can contribute to poverty reduction activities.

With regard to debt sustainability and the HIPC Initiative, my authorities will accelerate the implementation of the reforms needed to realize the completion point under the enhanced HIPC Initiative by the end of the year, and ensure that they will improve their economic management so that HIPC debt relief will be translated into tangible action in reducing poverty.

In the context of prolonged use of Fund resources, my authorities are convinced that the most important issue is the effectiveness of Fund programs in helping countries to graduate from exceptional resources and to design an exit strategy. In this regard, my authorities intend to prepare an exit strategy that will facilitate graduation from concessional resources while maintaining a prudent external borrowing policy. Looking ahead, my Senegalese authorities will continue to rely on technical and financial support from the international community to implement their economic program.

To conclude, I would like to thank Directors for their support for Senegal's request for a three-year arrangement. I will continue to assure Directors that we will transmit to the authorities your concerns, particularly on the issue of the large infrastructure projects designed by the authorities.

The Acting Chair made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. Directors commended the Senegalese authorities for their continued sound macroeconomic management of recent years. As a result, healthy per capita income growth was maintained, inflation remained low, and the external current account strengthened. Going forward, the key challenge facing Senegal is to raise the rate of economic growth to achieve a sustained reduction of poverty. Directors therefore called upon the authorities to implement structural reforms vigorously while maintaining macroeconomic and debt sustainability. Efforts to boost growth and reduce poverty will need to pay particular attention to reducing the rural/urban divide, improving private sector access to bank financing, enhancing productivity, and reducing labor market rigidities.

Directors urged the authorities to continue to build on their prudent fiscal management of recent years. The fiscal balance will shift to a deficit in 2003, reflecting increased expenditure in priority areas identified in the poverty reduction strategy paper (PRSP) that will be financed in large part from HIPC debt relief and other concessional assistance. Directors welcomed the authorities' readiness to curtail non-priority spending to protect the fiscal stance. They, nevertheless, urged the authorities to take further measures to boost revenue in 2003 and the medium term, while pursuing the objective of creating a more efficient, transparent, and business-friendly tax system. They felt that this will be helpful to protect expenditure objectives.

Directors welcomed the authorities' decision to base their medium-term financial framework on the prudent scenarios of the PRSP, which reflected cautious assumptions about the government's implementation ability, the economy's absorptive capacity, and aid availability. They supported the authorities' plans to accelerate spending in the social sectors and on basic infrastructure, in line with the priorities outlined in the PRSP. They also called for improved tracking of poverty-related spending.

Directors welcomed the proposals for improvements in the timeliness, scope, and quality of fiscal reporting, and the authorities' commitment to comply with the West African Economic and Monetary Union (WAEMU) expenditure management reform program. They agreed that an increase in civil service employment may be appropriate to alleviate shortages of staff in social services, domestic security, and revenue administration. However, Directors underscored the need to ensure that the increased hiring is based on a careful assessment of staffing requirements, takes into account the long-run impact on the public finances and pension reform, and does not lead to an excessive expansion in public sector employment.

As regards the envisaged large infrastructure projects under public-private partnership, Directors expressed concern about the potential long-term quasi-fiscal and governance risks that could emanate from poorly designed and nonviable projects, as seen in some other countries. Accordingly, they underscored that implementation of these projects should be based on careful cost-benefit analysis, be consistent with fiscal prudence and macroeconomic stability, and draw on fully transparent selection and implementation procedures. In this context, Directors noted the authorities' commitment to provide Fund and World Bank staff, as part of a consultation process, with all the information needed to assess the technical, economic, and financial viability of those projects. At the end of this process, the Fund staff will assess the macroeconomic aspects to ensure consistency with the economic and financial program.

Directors urged the authorities to implement the structural reform agenda with greater determination and urgency in order to stimulate broad-based economic growth, reduce poverty, and strengthen the public finances. They emphasized that decisive action needs to be taken to address the financial and operational problems facing the state-owned electricity and groundnut companies. In this regard, Directors welcomed the development of a medium-term strategy for the energy sector, which includes plans for a carefully-designed privatization of the electricity company (SENELEC) to ensure reliable energy supply at moderate prices and boost productivity. They also called on the authorities to develop and implement reforms in the groundnut sector, including privatization of the groundnut company (SONACOS), which will be crucial for increasing efficiency in this sector and enhancing the prospects of the rural poor, for whom groundnut production is a major source of income. Directors welcomed the authorities' plans to reform the postal service and the pension system to ensure their financial viability, as well as their action plans to strengthen economic governance and remove administrative, regulatory, judicial, and financial impediments to private investment.

Directors noted that Senegal has largely maintained the gains in competitiveness derived from the devaluation of the CFA franc in 1994. They underscored the importance of developing a more diversified export base to reduce the vulnerability of the economy to adverse developments in export markets. Directors endorsed the authorities' efforts to promote growth through regional integration in the context of WAEMU, and welcomed the steps taken to eliminate tariff distortions, remove non-tariff trade barriers, and develop a common regional investment code.

Directors considered that the regional monetary policy of the BCEAO continues to serve Senegal well, by helping to keep inflation low and supporting the exchange rate peg. They were encouraged by the generally good health of the banking system and the measures being taken to further strengthen the financial system and promote financial deepening. Directors urged the authorities to improve the regulatory framework for the microfinance sector, given its growing influence in the financial system; to strengthen contract enforcement; to improve accounting standards in small- and medium-sized enterprises; and to increase information-sharing on creditors among banks. Directors underscored the need to pursue ongoing efforts within the Economic Community of West African States (ECOWAS) and WAEMU to strengthen legislation and enforcement in the areas of anti-money laundering and combating the financing of terrorism.

Directors regarded the quality of data as generally adequate for surveillance and program monitoring, but saw room for improvement in the timeliness and accuracy of both fiscal information and poverty and social indicators.

It is expected that the next Article IV consultation with Senegal will be held on the 24-month cycle, in accordance with the provisions of the decision on consultation cycles.

Points Relating to the Request for a Three-Year Arrangement under the Poverty Reduction and Growth Facility:

Executive Directors welcomed Senegal's new three-year economic program. They considered that the program is grounded in the development priorities identified in the poverty reduction strategy paper, and that it provides an appropriate framework for pursuing an important but unfinished reform agenda, especially as regards structural reforms in the electricity and groundnut sectors. They therefore approved Senegal's request for a new three-year arrangement under the Poverty Reduction and Growth Facility to support the program, as well as additional interim assistance under the enhanced Highly Indebted Poor Countries (HIPC) Initiative.

Directors welcomed the 2003 program, and considered that the medium-term financial program will foster macroeconomic stability and debt sustainability. The strengthening of public financial management will enhance transparency and, in conjunction with efforts to improve tax administration, expand the availability of public resources for priority sectors. These fiscal reforms will need to be adequately complemented by measures to address administrative impediments to private investment. Overall, the structural reform program was seen as the basis for fostering domestic and foreign investment, promoting economic growth, and laying the basis for sustained poverty reduction.

Directors underscored the importance of satisfactory progress in program implementation, in particular the strengthening of public expenditure management, as a condition for reaching the completion point under the enhanced HIPC Initiative. They noted that the design of Senegal's program paid due attention to enhancing its ownership, and expected that this will boost the prospects for its steady implementation. In this regard, they welcomed the authorities' efforts toward public monitoring and regular reporting on PRSP implementation, including the setting up of a Cabinet-level committee to report directly to the Prime Minister, with a view to raising the level of responsibility for, and interest in, successful reform implementation.

Directors noted that Senegal has been a user of Fund resources for over two decades, and that the authorities intend to prepare an exit strategy that will facilitate Senegal's graduation from the use of Fund concessional resources. This underscores the importance of timely completion of Senegal's unfinished reform agenda on the basis of a strengthened capacity for national economic management.

The Executive Board took the following decisions:

Poverty Reduction and Growth Facility—Three-Year Arrangement

1. The government of Senegal has requested a three-year arrangement under the Poverty Reduction and Growth Facility in a total amount equivalent to SDR 24.27 million.

2. The Fund approves the arrangement set forth in EBS/03/49, Sup. 1, 4/30/03 and decides that Senegal may request the first disbursement under the arrangement, on the condition that the information provided by Senegal on the implementation of the measures specified as prior actions in paragraphs 56 and 57 of the Technical Memorandum of Understanding attached to the letter, dated April 10, 2003 from Minister of Economy and Finance, is accurate. (EBS/03/49, Sup. 1, 4/30/03)

Decision No. 12996-(03/39), adopted
April 28, 2003

Enhanced Initiative for Heavily Indebted Poor Countries—Additional Interim Assistance

1. The Fund as Trustee (the "Trustee") of the Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations (the "Trust") decides:

(a) that satisfactory assurances regarding the exceptional assistance to be provided under the enhanced HIPC Initiative by Senegal's other creditors continue to be in place, and

(b) that the Trustee shall disburse to Senegal as additional interim assistance the equivalent of SDR 5.08 million, which shall be made available by the Trustee to Senegal in the form of a grant that shall be paid no later than three business days after the adoption of this decision to an account for the benefit of Senegal established and administered by the Trustee in accordance with Section III, paragraph 5 of the Trust Instrument; and the proceeds of the grant shall be used by the Trustee to meet Senegal's debt service payments on its existing debt to the Fund as they fall due, in accordance with the following schedule: 25 percent of each principal repayment obligation falling due from the date of this decision through December 31, 2003.

(c) For the purposes of Section III, paragraph 3(d) of the Trust Instrument, the conditions for the disbursement under (b) above are that the prior actions referred to in paragraph 2 of the decision approving Senegal's PRGF arrangement, adopted on April 28, 2003, have been met. (EBS/03/49, 4/14/03)

Decision No. 12997-(03/39), adopted
April 28, 2003

2. MOROCCO—2003 ARTICLE IV CONSULTATION

Documents: Staff Report for the 2003 Article IV Consultation (SM/03/119, 4/7/03; and Cor. 1, 4/25/03); Statistical Appendix (SM/03/132, 4/12/03; and Cor. 1, 4/25/03); and Financial System Stability Assessment (SM/03/125, 4/9/03)

Staff: Lazare, MED; Durand, MAE; Fisher, PDR

Length: 1 hour, 45 minutes

Mr. Daïri submitted the following statement:

Over the past five years, Morocco has made important strides in modernizing its political system, continuously liberalizing the economy and increasing its resilience to shocks, and laying the foundations for faster and more sustainable growth, reducing poverty, and improving the living conditions of the population. In the context of a delicate political transition and unfavorable domestic and international economic environment—including three successive years of severe drought, the increase in oil prices, and global economic slowdown—the authorities maintained prudent fiscal and monetary policies and stayed the course of structural reform. As a result, real GDP growth accelerated and its vulnerability to volatile agriculture production declined, inflation was brought down to industrial countries' levels, and the external position strengthened significantly with current account surpluses, improvement in debt indicators, and substantial reserve build-up. Attractiveness to foreign direct investment increased, as evidenced by the successful sale of a cellular phone license and privatization of the national telephone operator. My authorities thank the staff for the constructive dialogue during the Article IV consultation discussions, and they have agreed to the publication of the staff report.

Background

Successful democratic transition has been the overriding priority of the Moroccan authorities during 1998–2002. It was indeed crucial to maintain social cohesion to create the appropriate climate for an open and credible electoral process. Much of the authorities' attention was devoted to reforming the electoral code, strengthening human rights protection, and achieving national reconciliation following past abuses. They demonstrated strong commitment to improving governance, transparency, and accountability. The legislative and executive branches were involved in parallel investigations on high profile mismanagement cases and their conclusions were brought to the judiciary through a transparent process. Last August, and for the first time in Morocco's history, a democratically elected government reported to Parliament on implementation of its political and socio-economic program announced at its investiture, a major breakthrough in accountability.

The general elections held in September 2002 have been universally acknowledged as the fairest and most transparent in Morocco's history. The new government and its program have the support of a wide spectrum of political parties and the business sector, which augurs well for policy implementation. Confidence has strengthened and market perception has improved as evidenced by the narrowing in spreads in the secondary market and improvement in Morocco's outlook rating.

Macroeconomic Policies and Developments during 2001 – 2002

With lower-than-average agriculture performance and continued strengthening of non-agricultural activity, real GDP growth reached 4.5 percent in 2002 following 6.5 percent in 2001, allowing for an increase in real GDP per capita of 4 percent per year on average during 2001–2002. Improved government capacity to respond to droughts has helped attenuate their impact on the economy. The share of agriculture, including fisheries, declined from 15.4 percent of GDP during 1993–1997 to 13.8 percent during 1998–2002. While remaining high, urban unemployment has declined from a peak of 22.4 percent in 1999 to 18 percent in 2002.

Maintaining macroeconomic stability is key for achieving an enabling environment for high, sustainable, and private-sector-led growth. During 2001–2002, fiscal position improved significantly despite a decline in trade taxes following implementation of the FTA with the EU. After its peak of 6.4 percent of GDP in 2000, fiscal deficit, excluding privatization, declined to 5.8 percent in 2001—instead of increasing to 7.1 percent as projected in the 2001 Article IV staff report—and to 4.5 percent in 2002. The 6.1 percent of GDP privatization revenue received in 2001 was not used to increase expenditure, which declined as a share of GDP from 31.8 percent in 2000 to 31.1 percent in 2001 and 28.9 percent in 2002. Out of the DH 23.4 billion received in 2001, DH 8 billion was used to reimburse central bank's statutory advance to the Treasury (which is unremunerated and is not included in public debt) and DH 10.6 billion was transferred to Hassan II Fund and sterilized in a central bank account. In 2002, the current fiscal balance reached close to 2 percent of GDP and the primary deficit was virtually eliminated. Total government debt, as a percent of GDP, declined from 75.7 percent in 2000 to 74.8 percent in 2001 and 69.4 percent in 2002.

The effectiveness of monetary policy in achieving price stability, in an environment of large foreign exchange inflows, has been strengthened. Improved coordination between Bank Al-Maghrib and the Treasury and timely and effective use of policy instruments made it possible to mitigate the effect of privatization revenue and of the large increase in workers' remittances on liquidity. Money market rates remained within the central bank's intervention rates, and money developments were broadly maintained within the target range.

The exchange rate peg has continued to serve the economy well and has helped maintain macroeconomic stability. The depreciation of the dirham in April 2001, together with very low inflation and favorable movements of the euro in respect to the U.S. dollar helped reverse part of the previous real appreciation. The authorities also followed a moderate wage policy. In view of the high level of unemployment and to protect competitiveness, the minimum wage was increased only once, by 10 percent in 2000 since 1996, and has declined in real terms. The decline in interest rates and efficiency gains stemming from structural reforms also contributed to improved profitability and higher employment creation.

The tight macroeconomic stance, large workers' remittances and FDI inflows, improved export performance—including from greater diversification to new, high value-added sectors—and active debt management policy led to significant improvement in the external position, notwithstanding the decline in tourism and global economic slowdown. The current account position turned from a deficit of 1.4 percent of GDP in 2000 to a surplus of 4.8 percent in 2000 and 3.7 percent in 2002. External debt-to-GDP ratio declined from 48 percent in 2000 to 35 percent in 2002, and debt service ratio declined further to reach 16.6 percent in 2002. Reserve coverage increased to the equivalent of 9 months of imports. As a consequence, the ratio of external public debt net of official reserves to GDP declined from 71.5 percent in 1990 to 10.2 percent in 2002.

Recent Progress with Structural Reforms

The authorities do not agree with the assessment that only a limited part of the government's reform agenda was implemented or that structural reform stalled for most of 2002. Despite the heavy political agenda and in addition to financial reforms, which will be highlighted in the following section, key reforms were implemented that included:

Dismantling of tariffs under the Association Agreement with the EU (AAEU), with the more sensitive phase of progressive elimination of tariffs protecting local production starting this year;

Elimination of reference prices and the adoption of customs valuation in accordance with WTO rules, leading to an improvement in Morocco's rating in the Fund trade restrictiveness index from 8 to 5;

Modernization of customs administration bringing its performance on par to that of the most advanced economies and eliminating one of the most serious impediments to trade;

Liberalization of the Telecoms sector, with World Bank assistance, allowing its opening to private sector involvement, including the sale of a second cellular phone license and privatization of Maroc Telecoms;

Liberalization of the edible oil sector with elimination of the high tariffs and of consumer subsidies;

Elimination of the price control system and enactment of the competition law;

Enactment of the law liberalizing road transportation, and eliminating the state monopoly;

Enactment of the law liberalizing the petroleum and gas sectors;
Liberalization of the tobacco sector, and reform of its taxation consistent with IMF technical assistance recommendation, in order to prepare its privatization, expected to be completed later this year;

Creation of regional one-stop windows to streamline investment procedures;

Creation of working groups to identify and address impediments to key sectors development within a contractual framework, with priority given to improving their efficiency and export performance, reducing their costs, and improving access to land;

Adoption of a charter for small- and medium-sized enterprises and of employment support mechanisms, with particular emphasis on training;

Reform of rent legislation to improve landlord protection and increase attractiveness of the sector to domestic and foreign investors;

Revision of the privatization law to extend the list of public enterprises subject to privatization;

Transfer to public pension funds of unfunded retirement schemes of key public enterprises, including the railway company (ONCF) and the tobacco company (Regie des Tabacs), and mobilization of resources equivalent to 2 percent of GDP for meeting their liabilities, with government support. This transfer will improve these enterprises' finances and transparency and help prepare them for privatization;

Restructuring of the airline and maritime transportation companies and of a number of other public enterprises, and liquidation of the coal and iron mines companies;

Adoption of a new law reforming public procurement regulation to enhance transparency and competition;

Reform of the job intermediation system;

Strengthening of the judiciary with creation of commercial courts and regional courts of accounts and acceleration of execution of court decisions;

And finally, the creation of an Ombudsman position to mediate disputes involving government entities.

Financial Sector Reform and the FSSA

Significant progress has been made over the past two years in strengthening the financial sector, including through improved regulation and supervision. In addition to the ongoing restructuring of specialized financial institutions, recent reforms include the overhaul of the accounting system to bring it on par with international best practices, the imposition of internal audit procedures, the upgrading of loan classification and provisioning rules, and the imposition of prudential regulations on a consolidated basis. The draft law reforming the central bank's charter to provide it with more operational independence has been revised to include key FSAP review mission recommendations. The law will assign price stability as the primary objective of monetary policy, create an independent monetary policy committee, prohibit budget financing under normal circumstances, phase-out central bank's shareholding in any financial institution, submit its accounts to independent external auditors, clarify the roles of the Ministry of Finance and the central bank in exchange rate policy, and open the possibility for the Governor to report to Parliament.

The reform of the banking law aims at strengthening Bank Al Maghrib's supervisory role, redefining the roles of the two consultative bodies, and enhancing coordination among financial sector supervisors. The two revised draft laws are to be considered soon by the Government. After transformation of its legal statute, the opening of the capital of the major public commercial bank (BCP) is proceeding according to schedule. Following sale of 21 percent of its capital to private regional banks last year, the floatation of 20 percent of the capital has been announced recently. The new Insurance Code has been approved. This Code increases protection of the insured and improves the regulatory and prudential framework. As recommended by the FSAP rev iew mission, the 50 percent shareholding limits in individual insurance companies and joint liability for co-insurance have been eliminated.

My authorities thank the staffs of the Fund and the World Bank for the exhaustive work carried out under the joint FSAP review. While they share many of the assessments of the FSSA and concur with the needed reforms, they consider that the report does not fully and accurately reflect the recent major reforms and those in progress. They also believe that some of the vulnerabilities highlighted in the FSSA are either overstated or based on unrealistic assumptions inconsistent with the recent stance and orientation of macroeconomic policy and financial sector reform. They are of the view that vulnerabilities should be assessed against the present stance of policy and not in relation to what would happen if the capital account was liberalized. Capital movements are already free of restrictions for non-residents, including Moroccan workers abroad. The authorities are also aware of the prerequisites for moving toward full capital account liberalization and exiting from the present exchange rate peg and, in particular, the need for further improvement in the fiscal position, monetary framework and instruments, and strengthening of the financial sector. In this respect, they have requested Fund technical assistance in bank and insurance supervision and pension reform. I will comment on a few areas of “vulnerability” identified by the mission.

The Specialized Banks

Two major factors explain the poor performance of the three specialized banks: the high cost of their long-term borrowing at historically high interest rates at a time when domestic interest rates have declined significantly, and difficulties faced by their borrowers, in particular in the drought-stricken agriculture and in tourism. These difficulties were exacerbated by poor governance which is being addressed forcefully. The restructuring and financial rehabilitation of the three institutions is being conducted in a transparent manner with reliance on the shareholders and direct or indirect government support. Despite the accumulation of reserves in the Deposit Guarantee Fund financed by contributions by the banking sector which could have been used for rehabilitation of the three institutions, these reserves were not used.

The Agricultural Bank (CNCA) received government support amounting to DH 1.2 billion during 1998–2000 (0.4 percent of GDP) and was recapitalized by the Government in 2001 for an amount of DH 1.2 billion. A draft law modernizing its charter to enable private participation and separating the commercial part of its activity from social development objectives is under discussion in Parliament. Under the new law, all non-commercial activities will be undertaken on a contractual basis and will be financed by the Budget. Following severe shortcomings identified by an audit, management of the CNCA has been changed and an improvement in its performance is underway with a significant increase in its deposit base and profitability.

A restructuring plan covering 2000–2006 has been negotiated by the new management of the Housing and Tourism Bank (CIH). This plan calls on shareholders as well as government support for a total of DH 6.6 billion (over 1.5 percent of GDP), together with a program of loan recovery and cost reduction, including early repayment of expensive debt. Implementation of the plan is proceeding satisfactorily, with most of the financial support already disbursed. Two years into implementation, the plan has achieved a 30 percent decline in nonperforming loans, 20 percent increase in deposits, a significant increase in net banking product, and a decline in operational costs. While recognizing that the situation of the CIH is still difficult, the authorities and the CIH management are confident that the plan is working and that the bank will be put on a sound footing even earlier than anticipated under the program. Following its financial rehabilitation, the CIH could be privatized, or merged with another institution.

In addition to its deteriorating financial position, the role of the industrial development bank (BNDE) within the liberalized financial system was put into question. After considering several options, the authorities decided to liquidate the bank and transfer its retail bank activities to the Agricultural Bank (CNCA), which needs to develop its urban branch network, and its investment bank activities to the Caisse de Depots et de Gestions (CDG) which is a public asset management bank and also the second largest shareholder after the Treasury. A contract has been signed between the Government and the CDG giving this institution responsibility for the liquidation, with the final cost being borne by the CDG pro-rata to its shareholding and by the Government for the remainder.

While remaining committed to completing the rehabilitation and restructuring of the three specialized banks, the authorities do not believe that their situation had at any time posed serious risks to the stability of the financial system. The links between these institutions and the private financial sector are not very strong. Public disclosure of these institutions' weaknesses also provided assurance that the necessary restructuring and recapitalization measures would be taken by the authorities. Finally, the cost of recapitalizing the two insolvent institutions, to comply with the minimum capital adequacy ratios, was estimated by the FSAP review mission at 1 percent of GDP.

The authorities do not see systemic risks to credibility of bank supervision arising from the exemption from prudential regulations granted to the two specialized banks. These exemptions are transparent and temporary and are accompanied by restructuring plans which are at an advanced stage of implementation. Furthermore, these exemptions do not create unfair competition to private banks in view of their significantly larger interest margins as well as the relatively small size and the sectoral concentration of the specialized banks.

Risks related to the macroeconomic stance and public debt

The authorities have demonstrated commitment to macroeconomic stability, and their stance of policies does not pose risks to the financial system. Indeed, the significant decline in government external debt and the increase in foreign reserves have mitigated most of the risks stemming from exchange rate and interest rate shocks. While part of the decline in external debt was replaced by domestic debt, this was achieved in a context of a general decline in domestic interest rates and has been instrumental in developing the financial system. Moreover, overall public debt has declined significantly, and this trend, under current policies, is expected to continue. The share of domestic debt in banks' assets is also relatively small, not exceeding 20 percent, and a significant part of it is held by a public bank. While there were episodes of accumulation of domestic arrears—the most recent being at end-2000 and was due to the delay in receiving the proceeds from the sale of the cellular phone license—there has never been any incidence of accumulation of domestic debt arrears. With strengthened fiscal position and expenditure control, enhanced cooperation with the central bank, and improved liquidity and debt management, the authorities are confident that there is no risk of accumulation of debt or non-debt arrears.

Workers' Remittances

Workers' remittances have increased significantly over the past two years. Past episodes of rapid increases were typically followed by stability of the inflows with no incidence of sharp declines. Deposits held by expatriate Moroccans are maintained for liquidity purposes to face family support needs or for potential investments. Also these deposits are held in dirham, often in unremunerated accounts, whereas expatriate Moroccans have the opportunity of maintaining them in foreign currency, or in convertible dirham accounts. The authorities, therefore, do not see any risk of a sudden decline in these deposits.

Interest Rate Formation

The authorities do not agree that participation of public entities (CDG, BCP) in the Treasury bill market creates potential conflict of interest. The two institutions have full operational independence and make their investment decisions consistent with their own strategies. Interest rates are dictated by market conditions on an auction basis, and there is no evidence of collusion between the Treasury and these public entities. In the authorities' view, interest rate structure in the Treasury bill market appropriately reflects the preferences and expectations of market participants and provides a credible benchmark.

Social Sectors and Poverty Reduction

With assistance from the World Bank, the EU, and other donors, the authorities are implementing a broad strategy to increase delivery of social services and reduce poverty. This led to improvement in key indicators, including in education, health, access to drinking water and electricity, and significant progress in reducing geographic and gender disparities. Primary school enrollment increased from 65 percent in 1998 to 81 percent in 2001 on average. The gender gap is being closed with the rates of girls to boys increasing over the period from 0.94 percent to 0.99 percent in urban areas and from 0.73 percent to 0.80 percent in rural areas. Between 1997 and 2001, access to drinkable water in rural areas increased from 26 percent to 48 percent and access to electricity from 24.5 percent to 51 percent. An important breakthrough was the adoption of the Education Charter comprising several laws and regulations establishing a tight timetable for achieving universal enrollment, improving the quality of education, and strengthening its link to job market needs. An ambitious private-sector-led program for reducing housing shortages, particularly for the low-income population, is underway. Key social reforms also include the creation of the Social Development Agency with World Bank assistance to address poverty issues, rehabilitation of key social protection agencies, including the Social Security Fund, and generalization of job accident and healthcare protection. The authorities also succeeded in developing a decentralized and efficient system for alleviating the social and economic effects of droughts, thereby strengthening the economy's resilience to weather-related shocks. This system has enabled a timely reallocation of budgetary resources while maintaining fiscal discipline and accountability.

Data ROSC

My authorities express their appreciation to the staff of STA for the comprehensive review of data dissemination and quality and concur with their conclusions and recommendations. The authorities have agreed to the publication of the report which has been already posted on the Fund's web site. This review has helped identify areas where more efforts are needed to enable Morocco to meet the SDDS requirements and to subscribe to the SDDS by end-2003.

Policies for 2003 and over the Medium Term

The government's economic program announced last November aims at further modernizing the economy and enhancing its competitiveness to achieve higher and more balanced growth and job creation. In pursuit of this objective, the government will rely on macroeconomic stability, structural reforms, human resource development, and strengthened governance and policy predictability to improve the attractiveness of the economy to domestic and foreign investors. Recent strengthening of business confidence and favorable weather developments so far augur well for acceleration of growth to 5.5 percent in 2003, the average for the past two years. With improved outcome for 2002, the traditionally conservative revenue projections, and strong revenue administration and expenditure control, the fiscal deficit could be closer to 4 percent than to the 5 percent projected during the Article IV discussions. Medium-term fiscal consolidation will remain at the core of the authorities' priorities, with the overall deficit, excluding privatization, projected to decline further to reach 3 percent of GDP by 2008. In reaching this target, priority will be given to civil service reform, including a substantial retrenchment program based on early retirement and changing promotion into a merit-based system, liberalizing the sugar and cereal sectors and overhauling the untargeted subsidy system, and reforming the tax system to increase its buoyancy and offset the decline in trade taxes. The social orientation of the budget will also be strengthened to enhance the delivery of key public services.

Closer consultation with social partners augurs well for achieving early consensus on some of the pending issues, including the adoption of a new Labor Code. Broad consultation with the business sector will also help introduce the necessary reforms for raising efficiency and competitiveness to enable the economy to reap the benefits of globalization and of the AAEU and the free trade agreements with Arab countries. Prospects for improved cooperation among Maghreb countries and of early conclusion of ongoing negotiations for a Free Trade Agreement with the United States are also encouraging.

The effect of the war in Iraq has not been as severe as expected. Indeed, oil prices seem to have stabilized and the tourism sector, so far, has been affected less than in other countries in the region. Fiscal and price developments for the first two months have been favorable. Tourism receipts and workers remittances, in particular, have increased, while the trade deficit has widened, with an increase in exports more than offset by a surge in imports, especially for investment goods. However, foreign reserves were maintained at their historically high level of end-2002. While it is too early to assess the extent of the fall-out from the war, the authorities believe that the traditional political stability in Morocco and the safe environment, together with the large reserves cushion, will help maintain investor confidence and strengthen their resolve in the pursuit of their economic and social objectives.

My authorities attach high importance to their close cooperation with the Fund. The extensive exchange with the staff during the Article IV consultation discussions, the FSAP review, and data ROSC missions has been very useful. The authorities look forward to Board's discussion and advice in articulating and implementing their strategy.

Mr. Shaalan and Mr. Kanaan submitted the following statement:

Following three consecutive years of severe drought, which induced a marked contraction in agricultural output, Morocco's macroeconomic performance improved in many respects since 2001. The current account deficit narrowed, official reserves increased, and the debt-to-GDP ratio declined, while inflation remained at industrial country levels. In 2002 there was a significant increase in economic activity, driven by a strong rebound in private consumption and a rise in non-traditional exports. The fiscal stance was tightened significantly last year, in large part due to a reduction in wage expenditures, which is all the more impressive as it occurred during an election year. The new government has conveyed strong signals regarding its intention to persevere in the fiscal consolidation efforts and create favorable conditions for private sector investors in Morocco, with the declared aim of setting the economy on a higher growth path and reducing poverty and unemployment. Our comments will focus on some of the key challenges which the new government will need to tackle to achieve these objectives, notably in the fiscal and structural areas.

We encourage the authorities to build on the strong public confidence in the new government's reform agenda, and the overall improvement in economic conditions, to implement measures that would permanently reverse the trend of fiscal deterioration started in 1999. We share the staff's view that fiscal policy should aim at steadily reducing the budget deficit to 3 percent of GDP in the medium-term, a level that can be comfortably financed from domestic sources once privatization proceeds dry up, and is consistent with a declining trend in the debt-to-GDP ratio. The new government has already taken some measures that bode very well in this regard, including initiation of reform in the remuneration and promotion system in the civil service, and a decision not to increase public employment in 2003. We also agree with the staff that the aim should be to reach a budget target of 4 percent of GDP for 2003, which could be achieved if the authorities maintain a tight control over the wage bill, reduce contingency allocations, and take steps toward reducing subsidies on sugar and flour. It is important, however, that the food subsidies not be hastily lifted before an adequate safety net is in place to temper the impact on the vulnerable segments of the population.

The authorities would be well served to elaborate a full-fledged medium-term expenditure strategy, taking into account the recommendations of the recently-completed public-expenditure review, with a view to minimizing unproductive expenditures, improving the quality of public services, and raising the effectiveness of health and education spending. It is also important to initiate tax reform measures promptly with a view to preventing a further erosion of the tax-to-GDP ratio. Toward that end, it is important to announce a time bound plan to phase out VAT exemptions, and raise the yield of direct taxes by minimizing selective investment incentives and sector-specific tax holidays.

On the treatment of the special investment fund (Fonds Hassan II), we agree with the staff that, to enhance fiscal transparency, it is important to consolidate the fund's operations with those of the central government, as recommended by the ROSC mission. While such consolidation will not significantly affect the picture on fiscal performance, given that the fund has been in near balance (with privatization receipts broadly matching its expenditures), the situation could rapidly change in view of the present uncertainties regarding the timing and magnitude of privatization receipts down the road. Furthermore, its integration will reinforce the new government's signal with regard to its determination to ensure a high level of transparency of public sector operations.

In the structural reform area, we welcome the steps that have been taken to create a business-friendly environment, notably the establishment of one-stop investment windows at the regional level, the implementation of the 1999 law liberalizing the transportation of goods, and initiation of the privatization process for the tobacco company. We encourage the government to sustain private sector confidence by pushing ahead with key reforms which in the past have stalled, partly due to pressures from interest groups, notably the implementation of laws to promote domestic competition and relax labor-market rigidities. We commend the authorities for the impressive progress made in trade liberalization, in which an important recent step was the elimination of reference prices on imports, as indicated in Mr. Daïri's very helpful statement. Like the staff, we encourage the authorities to complete the liberalization process by further lowering the external tariff in line with the reduction in preferential rates under the association agreement with the EU. However, it is important that this be carried out in parallel with measures to raise domestic tax yields as outlined earlier, in order to prevent a further reduction in the share of tax revenue in GDP.

We welcome the recent preparatory steps toward addressing weaknesses in financial supervision noted in the financial system stability assessment, including the drafting of new central bank and banking laws, and the request for technical assistance from the Fund. The authorities would be well served to proceed vigorously in bringing the two specialized banks in compliance with prudential regulations and reserve requirements. It is also important to strengthen the supervision agency's procedures to promptly detect problems in banks and take remedial actions, as well take steps to deepen financial markets. These measures are especially important to pave the way for an eventual relaxation of capital account restrictions.

With these comments, we wish the Moroccan authorities continued success.

Mr. Zoccali and Mr. Ayala submitted the following statement:

We thank the staff for the focused reports and Mr. Daïri for his informative statement. Over the last decade, the authorities of Morocco have adopted prudent economic policies that have contributed to achieving macroeconomic stability. This has been reflected in the past two years in low inflation, an increased level of foreign reserves and current account surpluses, and a declining level of foreign debt. Moreover, while a severe drought has affected agricultural performance in recent years, the economy has shown positive real growth for the third year in a row. Nevertheless, GDP growth remains weak and insufficient to absorb the high unemployment rate and reduce the widespread poverty.

To raise the living standards of the Moroccan population and ensure sustained economic growth, the authorities face significant challenges. As the staff report makes clear, there is ample room for improving growth potential through structural reforms, the pace of which should continue and in some cases be accelerated to upgrade the overall environment for private activity. The continued consolidation of the fiscal position is also deemed crucial to strengthen confidence, lower the debt burden, and regain flexibility to respond to adverse shocks. In this vein, we are in broad agreement with the staff appraisal and we will confine our comments to a few aspects for emphasis.

We are encouraged by the improved fiscal outcome in 2002 after three years of expansionary fiscal policy leading to some concern over the sustainability of fiscal deficits, particularly after budgeted privatization proceeds failed to materialize in 2002. We commend the new authorities for their efforts to lower further the deficit in 2003, and in particular, as pointed out by Mr. Daïri, for their resolve in prioritizing civil service reform to lower the significant incidence of the wage bill on the fiscal balance. We urge development of a medium-term expenditure strategy aimed at increasing the quality and effectiveness of public expenditure. Similarly, the strengthening of the social safety net is deemed important to mitigate the impact from the reduction in sugar and flour subsidies on the most vulnerable segments of the population.

On the revenue side, we concur with the staff on the desirability of stabilizing the tax to GDP ratio in the medium term, to offset the declining tax revenues, especially due to the reduction in external tariff rates. In this regard, we encourage the authorities simplify the existing VAT rate structure, to phase out reduce tax holidays and special exemptions and to broaden the tax base while transferring responsibility for VAT collection to the tax department, to improve administration and collection.

Owing to prudent monetary and exchange rates policies, inflation has been low in recent years. In fact, the devaluation of the dirham in 2001 and the realignment of the currency basket, with a larger share for the euro, did not accelerate inflation. Additionally, it helped to improve export performance and the external position. Similarly, the authorities were successful in 2002 in sterilizing the excess liquidity coming from large private external transfers.

In the current context of relative macroeconomic stability, the authorities should give further consideration to the most appropriate nominal anchor for the medium term keeping in mind that trade and capital account liberalization entail a greater potential vulnerability to external shocks and the importance of enhancing external competitiveness for stronger growth. The staff's call to reshape monetary and exchange rate policies, as Morocco's financial and trade integration progresses, underscores the importance of building credibility for the new monetary framework before abandoning the current arrangement. In this regard, we attach utmost importance to the making effective headway to meet the three key conditions outlined in paragraph 29 of the main staff paper, namely, significant progress toward fiscal consolidation, strengthening the financial system and preparing bank supervision to operate in an environment of growing financial integration.

We concur with the staff that Morocco has been making considerable progress in liberalizing trade and opening up its financial system. We commend the authorities for their participation in the Financial Sector Assessment Program. The conclusions in the staff report that the banking sector is globally healthy and growing is encouraging. However, the identified vulnerabilities are also significant and need to be systematically addressed. The overhaul of financial system's legal and regulatory framework now calls for consistent implementation. The relatively high level of non-performing loans, in particular in the specialized banks, and the absence of an official framework for handling systemic problems of illiquidity serve to highlight its potential fragility. In this vein, we broadly endorse the staff recommendations, and welcome the mutual steps taken to improve the performance of the state-owned specialized banks. More generally, regarding financial sector supervision, the approval of the draft banking law to enhance the powers of the BAM, the phased strengthening of the strategic review and clearer definition of operational objectives of banking supervision, and the provision of adequate resources for a more effective oversight of the financial system are deemed critical.

Lastly, we welcome the new authorities' intention to continue with necessary structural reforms and commend them for the steps already taken to improve the business climate. In this context, we encourage the authorities to advance the privatization program in a manner that secures economy-wide efficiency gains, to continue with the modernization of the civil service and labor market legislation, to further liberalize multilateral trade, and to improve competitiveness and the functioning of domestic markets, in particular to help create jobs and reduce unemployment. In this context, the Moroccan economy could be particularly well-placed to benefit from trade creation opportunities associated with initiatives to develop European and intra regional trade. With these comments, we wish the authorities continued success to achieve Morocco's shiny growth potential.

Mr. Ondo Mañe submitted the following statement:

Over the past few years, in spite of important political changes and severe drought conditions, which adversely impacted agricultural output and real GDP, the Moroccan authorities, as Mr. Daïri noted in his comprehensive and informative statement, have implemented significant macroeconomic and structural reform measures, which have been instrumental in maintaining macroeconomic stability and economic growth. Inflation has been kept low, the external current account is in surplus, international reserves are at a comfortable level, and the exchange rate has remained broadly stable. The debt-to-GDP ratio has declined, although the fiscal deficit has remained relatively high, and output in the non-agricultural sector has continued to grow. In the structural area, the privatization and the restructuring of public enterprises have been pursued, and the authorities have implemented, among others, a comprehensive program of trade liberalization. Overall, we view the economic and financial performance of Morocco as very encouraging, and we commend the authorities for their management of the economy.

Building on this foundation, the new government that took office last year has put in place a program of reform that aims at accelerating economic growth, reducing the fiscal imbalance and addressing constraints to growth. Already, we note an improvement in business confidence. Favorable agricultural output and the removal of the uncertainty associated with the War in Iraq are likely to raise real GDP growth to above 5 percent in 2003. This improved growth performance should also help the process of fiscal consolidation which was hindered in the past by lower growth.

Notwithstanding these developments, we share the view that the authorities should undertake additional measures both on the revenue and expenditure sides to ensure a permanent reversal in the fiscal trend. This will also be important to bring the debt-to-GDP ratio to 60 percent or below. Tax revenues have declined in the past two years, mainly owing to a reduction in tariff rates, while revenues from the VAT have also declined due to an increase in tax exemptions. It will be important for the authorities take steps to broaden the tax base, and they should review their policy on exemptions with the view to reducing them. Improving tax administration will also help. On the expenditure side, the efforts to reduce the wage bill should continue.

We also believe that efforts to reduce the deficit should continue over the medium term. On this issue, the staff indicate that the fiscal deficit should be brought to below 3 percent of GDP, and that the public debt-to-GDP ratio to about 60 percent of GDP. We agree with these objectives, but it is not clear how they will be achieved. We would appreciate the staff's comments on measures that they think are needed to achieve these objectives.

In the monetary and exchange area, we note the authorities' prudent approach, which has ensured macroeconomic stability over the years. We, thus, welcome the determination shown by the authorities to mop up excess liquidity in 2002, which is contributing low inflation and the competitiveness of the Moroccan dirham. However, we note the growing integration of the Moroccan economy into international financial markets and the need to maintain the competitiveness of the currency over the longer term. Thus, we agree with the staff's recommendation to shift toward a flexible exchange rate regime. However, monetary policy will need to make price stability its primary objective. In this light, is the staff advising the authorities to move to an inflation targeting framework? We also note that to ensure macroeconomic stability in the context of a flexible exchange rate, it will be important that more progress should be made towards fiscal consolidation.

We welcome the FSAP review report which indicates that the financial sector is not a source of risk to the economy, and that the commercial banks are in reasonably good condition. However, the report underlines that there are areas of weaknesses in the financial sector. The authorities have already taken actions to deal with some of these weaknesses, and we support their request for technical assistance in the area of banking supervision. We encourage the authorities to step up the reform of the financial sector along the lines suggested by the report so as to enable the financial sector to deepen its role in the development of the economy. We also agree that steps should be taken to bring the two insolvent public banks into compliance with the central bank's prudential regulations.

Unemployment is a major challenge facing the authorities, and, despite a positive real growth rate, it is too low to raise per capita income in a significant way and to reduce poverty. As noted by Mr. Daïri, Morocco has done much to achieve broad macroeconomic stability. The authorities have also implemented some important structural reforms, but the growth rate remains inadequate indicating the need for a more vigorous effort in the area of structural reforms. It seems that there are still major obstacles to an efficient allocation of resources and to market functioning. The authorities are aware of these constraints, and have indicated their willingness to address them. We, therefore, encourage them to accelerate the implementation of market reforms so as to increase competition in the products market. The labor market is also subject to major rigidities, and we welcome the authorities' intention to address them and to submit a new labor code to parliament in 2003. However, we agree with the authorities that it is also important to pay attention to the need to maintain social cohesion and peace.

In conclusion, we commend the authorities for their determination to address the challenges that face the Moroccan economy, and we wish them continued success in their efforts.

Mr. Portugal and Mr. De Silva submitted the following statement:

We thank the staff for a well written report, which contains a wealth of useful information, and Mr. Daïri for his comprehensive statement. Morocco has achieved a reasonable degree of macroeconomic stability but similar success at putting the economy on a path of sustainable long-term growth has proven elusive. The economy posted a reasonably vigorous real growth rate of 4.5 percent in 2002, but remains vulnerable to the uncertainties that stem from high dependence on the agricultural sector. In the face of these structural constraints, we agree with the shared assessment of the staff and the authorities that the major challenge for Morocco is to accelerate the pace of economic growth. This in turn will require the fast-tracking of economic and administrative reforms, while maintaining efforts to consolidate macroeconomic stability.

On this latter score, the authorities must be commended for their success in lowering the fiscal deficit by close to 1 percent of GDP in 2002. However, there remains room for further fiscal tightening and for strengthening the transparency of fiscal operations, particularly with respect to the role of privatization proceeds. While ongoing tariff reform has imposed a measure of uncertainty with regard to the revenue outlook, the establishment of well-defined targets and a clear time path for the reduction of the fiscal deficit, excluding privatization, are needed in order to reach more sustainable levels. In this connection we are encouraged by the decisive measures being contemplated by the authorities to lower the high wage bill in the period ahead. Tighter fiscal management will also help to further reduce overall levels of public sector indebtedness which, though declining, remains relatively high at just over 70 percent of GDP. Reductions in external debt have been counterbalanced by increases in the domestic debt stock.

Although there was some weakening in 2002, the external accounts have remained resilient even in the context of trade reforms that have lowered import duties. The earlier decision by the authorities to adjust the currency peg was appropriate after an extended period of real appreciation. However, continued reliance on discrete adjustments may be inadequate to preserve the long-term competitiveness of the export sector. Given its well known volatility, the important tourism industry could be susceptible to external risks arising from the recent war in Iraq and its possible lingering after-effects.

On the other hand, monetary policy may now be well placed to play a more important role. The strong and proactive stance of monetary policy has been effective in keeping inflation under control even in the aftermath of a nominal currency devaluation and in the face of large, liquidity generating inflows. This has also strengthened the credibility of the Central Bank. The authorities should continue to use monetary policy assertively to dampen inflationary pressures.

Morocco is making strong efforts to reduce its traditional vulnerability to climatic uncertainties by strengthening the non-agricultural productive base and improving industrial competitiveness. We support the authorities' efforts to reform the trade regime and integrate the economy more closely into the global economy. In this regard, we view the implementation of the Association Agreement with the European Union (AAEU) as well as the broader thrust towards the liberalization of trading relationships as positive initiatives that will act as a stimulus towards the diversification of Morocco's economy.

Morocco's economic management deserves much credit for its success in creating a stable macroeconomic climate. Consistent implementation of structural reforms, including privatization, is also critical to laying the basis for growth and improving the country's social indicators. We encourage the authorities to strengthen their efforts in this regard and wish them success in their future endeavors.

Mr. Alazzaz submitted the following statement:

The Moroccan authorities should be complimented for the favorable performance of the economy over the past year. Growth, while slowing, remained strong, inflation was low, and the fiscal position improved. Moreover, the external accounts were in surplus, reserves increased, and the debt ratio improved. Here, it is worth noting that these results were achieved against the backdrop of a slowing global economy and high geopolitical tensions. The outlook is also promising, as noted in Mr. Daïri's statement.

The challenge now is to build on the progress made in order to reduce the high incidence of unemployment and enhance the economy's resilience to the vagaries of the weather. In this regard, the authorities' strategy to enhance medium-term growth by focusing on maintaining a prudent macroeconomic stance and accelerating structural reform is welcome.

The authorities are to be commended for their prudent fiscal policies. The emphasis on cutting current spending last year has allowed for the needed investments while further reducing the fiscal deficit and the debt ratio. The containment of the wage bill and the progress in reducing subsidies are welcome steps. I am also encouraged by the efforts to strengthen the fiscal stance in 2003 and over the medium-term. The decision to freeze employment in the public sector at the current level should help in that regard. That said, it is important to monitor the situation closely and stand ready to take additional action if needed to help maintain the downward trend in the fiscal deficit. On the revenue side, additional efforts to strengthen the tax administration are important. Further revenue sources are also needed to offset losses stemming from external tariff reform. Here, I agree with the staff suggestion to overhaul the VAT and broaden its coverage.

Turning to monetary policies, the authorities deserve credit for their success on the inflation front. In this regard, a strengthened fiscal stance should facilitate financing the rising investment demand by the private sector, without placing undue pressure on interest rates. Broadening and deepening Morocco's financial market should also facilitate the conduct of monetary policy and enhance savings.

On the exchange rate, I agree that the current policy has served Morocco well. It is encouraging that data on exports show signs of growth and increased diversification. I also welcome the authorities' willingness to take further exchange rate policy actions over the medium-term. Here, it is important to emphasize that enhancing competitiveness depends ultimately on prudent macroeconomic policies and strong productivity gains.

Turning to the financial sector, the FSAP review mission's findings that the banking sector is broadly sound and does not pose a risk to stability in the short-term is reassuring. That said, the financial sector still needs to be broadened and deepened, especially given the growing integration into the international financial markets and the increased openness of the economy. To this end, the authorities are encouraged to implement the key recommendations of the FSAP review report as detailed in Box 6. In this connection, I welcome the ongoing efforts to strengthen supervision, including through Fund technical assistance.

In addition to prudent macroeconomic policies, enhancing growth prospects and employment creation depends on accelerating structural reforms. In this regard, I welcome the progress made in privatizing public enterprises and in improving the regulatory environment. However, there is room for additional efforts in both areas. The expected acceleration of the privatization drive this year is a welcome step that should improve efficiency and enhance competition. The ongoing trade liberalization should further contribute to efficiency, competition, and lower prices.

For the privatization drive to attain its full benefits, more flexible labor laws are needed. Indeed, in view of the high unemployment rate in Morocco, addressing the rigidities in this area is a priority. In this regard, I welcome the intention to submit to parliament a new labor code in the near future. Improving the regulatory environment should also facilitate the privatization drive and encourage investment. Here, I am reassured by the steps taken to streamline the investment process and enhance competition.

With these remarks, I wish the authorities every success.

Mr. Usman submitted the following statement:

Recent Developments

We thank the staff for their concise report and welcome the progress made by the authorities in forging a peaceful transition to a democratic society. We fully concur with Mr. Daïri that the period from 1996 when the authorities began their democratization and political reforms culminating in fair and open general elections in September 2002, cannot be characterized as time wasted, but a worthwhile investment in long-term social stability that is necessary for deepening economic reforms and maintaining macroeconomic stability. There are very few countries that can boast of synchronizing economic reforms and peaceful democratic transition.

The numerous reforms undertaken by the authorities are commendable and demonstrate that the authorities were equally concerned about improving economic performance during this time. Indeed, the reforms outlined in the staff report and in Mr. Daïri's statement are encouraging. A number of structural reforms were undertaken, including initiating labor market reforms, modernizing customs procedures and regulations, privatizing the Maroc Telecom, selling the cellular telephone license, liberalizing trade, and reforming the tax system. The authorities took measures to improve the fiscal outlook and to reduce the public debt.

The authorities also pursued prudent monetary policies, consistent with the exchange rate peg. They sought to benefit from massive capital inflows by increasing international reserves to 9 months of imports and mitigating the impact of these inflows on money supply so that inflation was reduced to industrial country levels. The current account deficit declined and the country's credit rating improved. Buoyed by political stability, we welcome that the authorities are appropriately geared to give their full attention to improving the performance of the economy. In this regard, going forward, we broadly concur with the staff's advice, and welcome the commitment of the authorities as noted in Mr. Daïri's statement. We will emphasize our comments in a few other areas for emphasis.

Growth Performance

Consistent with the authorities' goal of further consolidating social stability, we encourage them to deepen structural reforms and accelerate growth. A key problem remains the high level of unemployment. Measures to tackle unemployment should focus on two broad fronts—policies to put the economy on a high growth path and those aimed at reforming labor regulations. It is important to remove structural impediments to growth and to enhance the supply response of the economy, while attempting to reduce government involvement. Promoting competition and private sector led growth will help to reduce the economy's dependence on agriculture and the associated vulnerabilities.

Fiscal Consolidation

We welcome measures to reduce the fiscal deficit and the public debt. Given the high rate of unemployment, there could be pressure for civil service employment to become the safety valve. In this context, we encourage the authorities to resist pressures for hiring more civil servants so as to bring the government wage bill under control. Measures being taken to reduce other government expenditures are welcome. We encourage the authorities to benefit from the recently concluded public expenditure review and to improve the quality and composition of public expenditures, particularly on education, health and delivery of public services. On the revenue side, it is important to persevere with VAT reforms. We urge the authorities to remove the wide-spread tax exemptions which threaten to erode the revenue base.

We welcome the ongoing liberalization of trade. However, reduction in tariffs should be well-timed with the broadening of the tax base and other revenue raising efforts and expenditure reduction measures so as to avoid jeopardizing the goal of fiscal consolidation. Also, given the high rate of unemployment, the authorities should allow some lead time to domestic industry in the process of trade liberalization in order to mitigate potential side-effects to domestic industry, which could have negative impact on the tax base and employment creation.

Labor Market Reforms

Regarding the labor code, we concur with the proposed reforms listed in box 4 of the staff report, particularly by relaxing hiring and firing rules and desisting from government mandated minimum wages and encouraging wage bargaining. In this context, we share the concerns of the authorities on the need to strike a balance between enhancing labor market flexibility and social rights to maintain social peace. In this regard, we welcome the authorities' initiation of broad negotiations aimed at mobilizing consensus to achieve these goals.

Trade Reform

Morocco has made encouraging progress towards trade liberalization and the IMF's trade restrictiveness index has reduced from 8 to 5. It is therefore necessary to accelerate structural reforms aimed at enhancing competitiveness of the private sector. A competitive domestic industry will also help promote exports and maximize the benefits that can accrue from Morocco's preferential access to export markets. The ongoing negotiations for a free trade agreement with the United States should be accelerated and such an agreement on agricultural products will be a milestone and will have a salutary effect on economic growth and employment creation.

FSSA

It is encouraging that the FSSA mission found no immediate risk to the financial system and we encourage the authorities to consider the proposals made by the mission in order to further reduce vulnerabilities and the risk to the banking system.

We wish the authorities well in their endeavors.

Mr. Alowi and Mr. Salleh submitted the following statement:

We extend our thanks to the staff for the comprehensive set of papers and Mr. Daïri for his comprehensive and helpful statement.

On the whole, the Moroccan authorities deserve to be commended for their steadfast and untiring efforts to pursue challenging reforms on all fronts in order to elevate their economic achievements to a higher level. In 2002, all macroeconomic indicators have improved significantly. The authorities have undertaken a wide range of reforms although there remain some unfinished tasks ahead. It should be noted that the new Administration, which came into office last year, has embraced a more forward-looking approach particularly in the drive toward promoting private sector activity which has improved business confidence. In welcoming this development, we are reassured by Mr. Daïri's statement that the momentum of reforms already underway would be intensified which is vital in the authorities' desire to tackle the more critical issues of high unemployment and poverty.

As highlighted in the staff report, the key challenge confronting the Moroccan economy moving forward relates to efforts toward strengthening performance in growth and employment creation. Current pace of economic growth, which is closely influenced by the high volatility of agricultural output, is insufficient to absorb the growing labor force. To address these issues, the agricultural sector needs to be restructured to improve its productivity while efforts aimed at promoting new and more stable sources of growth as well promoting a more conducive environment for private sector investment initiatives need to be intensified. As the staff highlighted earlier, major obstacles to the efficient allocation of resources and functioning of the market have to be eliminated. In addition, efforts aimed at improving the educational achievements and skills of the population should also be given priority attention. All these are needed to enhance labor productivity and mobility in order to achieve a more balanced growth.

Beyond improvement in the real sector itself, more vigorous implementation of structural reforms is warranted. In this regard, we concur with the staff and authorities on the need to expedite the critical reforms needed to revitalize private sector activity and investment. The list of reforms that has been implemented as highlighted by Mr. Daïri in his statement is impressive and reassuring. We particularly welcome the authorities' plan to adopt a new labor code that would remove existing rigidities in the labor market and promote employment opportunities. This action would show the capability of the authorities to take the extra mile in instituting reforms that may be unpopular but surely not unnecessary. The authorities' efforts to improve the overall business environment including the proposed adoption of legislation for promoting competition are also very timely and should be expedited.

We concur with the staff recommendation on the need to further strengthen the fiscal position over the medium-term to ensure fiscal sustainability. This can be achieved from both expenditure and more so the revenue fronts. On the expenditure front, on-going efforts at compressing the wage bill largely through the freezing of new job creation in the public sector complemented by other measures such as improvement on promotion and compensation policies as well as the early retirement scheme are steps in the right direction. On the revenue side, we concur with the staff that there is more scope for improvement. This would entail substantial improvement and simplification of the VAT system, while the numerous tax exemptions need to be phased out. In regards to food subsidies, we would like to caution on their proposed removal if it has negative impact on the vulnerable group of the population.

We concur that the exchange rate peg has served the economy well and helped to ensure macroeconomic stability over the years. There is also no evidence that the exchange rate is misaligned. Furthermore, it is encouraging to note that the authorities are aware of the prerequisites for moving toward full capital account liberalization and exiting from the present exchange rate peg.

With respect to financial sector reforms, we commend the authorities for undertaking the FSAP review. The overall assessment of the health of the financial system is reassuring. Having said that, we welcome ongoing measures in line with recommendations to further strengthen the financial system.

We are pleased to note the substantial progress made in trade liberalization, as shown in Box 5 of the staff report, particularly the reduction in Morocco's trade restrictiveness. Nevertheless, while there is still scope for improvement, measures aimed at removing the remaining trade barriers would be done gradually and cautiously, in order to minimize their impact on the poor. Meanwhile, the authorities' efforts to initiate negotiations aimed at the creation of an FTA with the United States—including the agricultural sector—are an important development, which would generate growth in the export sector.

With these remarks, we wish the Moroccan authorities continued success in their future endeavors.

The staff representative from the Monetary and Exchange Affairs Department (Mr. Durand) informed the Board that the technical assistance that had been requested by the Moroccan authorities in relation to banking supervision issues had been initiated.

Mr. Daïri made the following additional statement:

The length of my statement should not be interpreted to mean that there were major differences in views between the staff and the authorities, especially as far as the direction of policies is concerned. There were some differences regarding the track record of structural reform implementation. It is important to point out that the democratization process in Morocco has been characterized by the private sector, during its meeting with the staff, as extremely important and worthwhile despite the delay that it may have had on some areas of structural reform. In particular, I am referring to the labor code which is probably the main issue where there have been delays. Discussions on the issue between social partners were very tense, and there was no complacency from the government in trying to bring a consensus among them.

I thank the staff of MED and MAE for their work on the FSSA. Here, there was also some difference in view, particularly on current and projected vulnerabilities. The report does not give credit to the current stance of policies and reform. There is an ongoing process of restructuring, particularly with regard to specialized public banks, which has not been fully reflected in the report.

I would like also to clarify two or three issues: one, on the Fonds Hassan II. This fund was created by the late King Hassan II, when the actual receipt of the sale of the second GSM license far exceeded budget expectations. Instead of the expected four billion dirhams, roughly four hundred million dollars, one billion dollars were generated by the sale. The late King did not want this additional money to be spent immediately, and that is why the Government established a special fund to be used as a catalyst for private investment and social spending. Some of the proceeds from the privatization of the national telephone operator have also been transferred to this fund. Spending from the fund is authorized under agreements that are publicly signed in the presence of His Majesty the King. This spending is fully transparent, and all information has been provided to the Article IV consultation mission and included in the fiscal accounts in the staff report. The fund's expenditures are subject to the usual control system to ensure compliance with regulations. Transparency and safeguards are therefore observed.

The authorities attach high priority to civil service reform and tax and pension systems reform. They are also making further progress toward modernizing the budget system. In fact, Morocco has one of the most advanced budget and control systems in the region. Here, I would like to address an issue that was raised in the staff report and in some statements, which relates to unallocated "or contingency" spending. This is not an item where the government maintains room for maneuver in order to spend more. These are allocations that correspond to measures and decisions taken in advance of the preparation of the budget. However, for technical reasons, it is not possible to have a detailed breakdown between ministries, or spending lines at that particular time. These expenditures are already budgeted, and there is no possibility for spending above the overall envelope of the budget.

Mr. Wei made the following statement:

I wish to thank the staff for their excellent report, and Mr. Daïri for his very comprehensive and helpful statement. The last two years have seen an impressive turnaround in Morocco's macroeconomic performance. Real GDP growth rebounded markedly, while inflation remained well contained. The current account has shifted to surpluses from deficits. Foreign reserves rose, and external debt was cut back. All these were achieved against the backdrop of three consecutive years of drought, a worldwide economic downturn, and geopolitical uncertainties. As the economy is now much more resilient to shocks, external vulnerability has been greatly reduced. The Moroccan authorities thus deserve to be commended for their prudence in running macroeconomic policies and their commitment to economic reforms.

Nonetheless, Morocco will continue to face the challenges of cutting unemployment, fighting poverty, and improving the living standards of its people. In order to successfully meet the challenges, the economy must move to a higher and sustainable growth path. The foremost tasks for the authorities will be to maintain macroeconomic stability and to press ahead with the agenda of economic reforms so as to reinvigorate private sector activity. In this connection, as demonstrated by the long list of work and work-in-progress in Mr. Daïri's statement, the authorities have already made substantial headway. I feel that it is important that we should not undermine or understate the authorities' achievements, especially given the special and difficult circumstances they face. Rather, we should encourage the authorities' reforms through all possible channels, in particular, by increasing and improving existing dialogues, and offering more professional advice and technical assistance. In this connection, let me join other Directors in welcoming the forward-looking approach that has been taken by the new administration, which, will quicken the pace and widen the scope of reforms.

On the macroeconomic policy front, the government took decisive steps to tighten its fiscal stance in 2002, thus delivering a much stronger fiscal outcome than projected. These efforts have successfully averted unfavorable trends in government revenue and expenditure ratios relative to GDP, and the deterioration of the country's overall debt position. It is encouraging to have Mr. Daïri's assurance that medium-term fiscal consolidation will remain at the core of the authorities' priorities, with continued measures to strengthen revenue administration and expenditure control. I welcome the projected deficit, which is closer to 4 than 5 percent for this year, and the target of 3 percent by 2008. Implicit in this target are very ambitious fiscal reforms that need to be forcefully implemented over the coming years, as explained by Mr. Daïri in his statement.

On the monetary front, the current framework, combined with the peg of the Moroccan dirham to a basket of currencies, has served the economy well and contributed to macroeconomic stability. The peg itself has provided an important anchor to keep inflation under control and its overall price level in line with its major trading partners. The performance of the external sector clearly suggests that misalignment is not an issue. Of course, however, reform of this regime is necessary in the long run, as the economy of Morocco advances further and integrates with the world economy. In this regard, the continued efforts to refine monetary instruments are welcome. However, moving toward full capital account liberalization and exiting from the present exchange rate peg are big steps that need to be carefully planned and implemented. The authorities are absolutely right to underscore the importance of having these prerequisites in place.

Regarding the financial sector, I commend the authorities for the significant progress made in recent years in strengthening the regulation and supervision of financial institutions, as well as overhauling the accounting system and imposing an internal audit. I welcome the findings of the FSSA that the financial system is generally sound and unlikely to be a source of macroeconomic risk in the near term. I commend the authorities for their prompt and response to the current weaknesses with the preparation of several draft laws and attempts to strengthen regulatory oversight. Needless to say, I fully support Morocco's request for the Fund's technical assistance to help in implementing the remaining policy reforms as recommended in the FSAP report.

On the subject of structural reforms, we acknowledge the progress and achievements that the authorities have made in recent years. However, they are encouraged to continue their efforts to carry out their as yet unfinished reform agenda. With these remarks, I wish the authorities every success in meeting future challenges.

Mr. Kruger made the following statement:

We would like to thank the staff both for the informative report and for the very interesting Financial System Stability Assessment. We would also like to thank Mr. Daïri for his helpful statement.

The staff notes that growth in Morocco has been insufficient to reduce poverty and unemployment. Thus, we agree that the country's primary policy challenge is increasing the rate of growth.

We believe that policy should focus on three areas in order to accelerate growth: maintaining sound macroeconomic fundamentals, increasing the competitiveness of the economy and reforming the financial sector.

Our first point is that sound macroeconomic policy is the foundation of sustainable economic growth.

Fiscal Policy

Increasing the rate of growth requires accelerating capital accumulation. In order to ensure that national savings can be translated into productive investments, public savings should increase and the debt-to-GDP ratio should decline. Morocco has made notable progress in this regard, with the central government debt-to-GDP ratio falling from 86 percent in 1992 to 70.6 percent in 2002. Over much of this period, primary surpluses resulted in the consolidation of the government debt. However, in the last couple of years, the decline in the debt ratio resulted from privatization receipts, as the primary balance turned negative.

A looser fiscal policy stance may have been appropriate in 1999 and 2000, when growth was weak. However, with the rebound in 2001 and 2002, we are concerned that failure to reduce the deficit (measured before privatization receipts) could be a sign of a structural weakness in fiscal policy. Indeed, the decline in the revenue-to-GDP ratio appears to be evidence that the authorities have not been successful in replacing the receipts lost through tariff reductions.

Looking forward, it will be important for the government to reverse the decline in the revenue-to-GDP ratio if it wants to provide the public services and infrastructure upon which growth depends. We support the staff in recommending enlarging the tax base and strengthening tax administration. However, like other Directors, we would caution against lifting food subsidies until a mechanism is found to compensate the poor. In the interim, the subsidies should be reformed to targeted to the poorest and not adversely affect incentives for agricultural production.

Monetary Policy

Monetary policy contributes to growth by providing price stability. With inflation between zero and three percent over the last five years, Morocco has had success in this regard.

With the growing integration of Morocco into international financial markets, the staff recommends moving to a flexible exchange rate regime after the three pre-conditions of fiscal consolidation, financial system strengthening and improved supervision are met. While the staff may be right, we believe additional analysis is called for. This Chair has long argued that an independent monetary policy is an important macroeconomic tool for buffeting the economy against shocks. Typically, an independent monetary policy is undertaken through a floating exchange rate and a nominal anchor like an inflation target.

However, in the case of Morocco, an independent monetary policy is achieved through the use of capital controls in the context of a fixed exchange rate regime. Thus, in assessing the ability of Moroccan monetary policy to contribute to growth, we must examine the costs and benefits of the capital controls. As we understand them, these controls do not prevent capital inflows, which allow Morocco to benefit from foreign savings. They do, however, prevent Moroccans from holding foreign currency assets, thereby exposing them to diversification risk. On the other hand, the controls mitigate other risks – in particular those associated with runs on the currency and capital account crises.

While it would be difficult to quantify these risks, we feel that the staff's assessment of their relative importance would be useful input into the authorities' decision of what monetary regime would best serve the country going forward.

Our second point is that increasing the competitiveness of the economy will lead to higher productivity. In the long run, increasing the rate of growth depends on raising total factor productivity. Trade liberalization can raise productivity by allowing the exploitation of comparative advantage. Morocco has taken important steps to liberalize trade through the Association Agreement with the European Union. We encourage the authorities to continue in this vein by negotiating free trade agreements with the United States and other countries.

We support the authorities in reforming labor markets since flexibility of the labor market will lead to a fuller use of labor resources as well as their more productive allocation. This too should increase growth prospects.

Our third point is that efficient financial intermediation supports growth by channeling savings to their most productive use. The FSSA notes that Morocco has a relatively large financial system, with financial sector assets equal to one and a half times GDP. However, the assets appear to be narrowly distributed, since only 15 percent of the population has bank accounts and the majority of the population does not have access to credit or other financial services. Moreover, the dependence on cash for transactions suggests that there is room to enhance financial intermediation.

The FSSA describes the dire situation of the specialized banking sector, which is characterized by poor capitalization, high net non-performing loans and losses instead of profits. The report suggests that recapitalization of the two large specialized bank to minimum eight percent capital adequacy ratio would cost the equivalent of one percent of GDP. While this should not be beyond the financial capacity of the government, it is troubling that such recapitalization follows previous assistance to these institutions during 2000-2001. The poor financial performance of these institutions and their ongoing need for state support either indicates a problem with the way in which they do business or suggests that they are a non-transparent vehicle for delivering subsidies. We are concerned that the large state-owned segment of the financial system, which is operated on a non-commercial basis, could undermine the development of a credit culture and efficient financial intermediation. We would suggest that the authorities consider other ways to develop a financial system which can promote the acceleration of economic growth. We believe that the FSSA provides a useful roadmap for financial sector reform. We urge the authorities to publish the report as a way of increasing transparency and promoting public discussion.

Finally, we would like to wish the authorities every future success.

Mr. Baukol made the following statement:

We thank the staff for the useful set of papers and the Secretary's Department for the foresight in scheduling the Board discussion on a Monday, giving us a weekend to read Mr. Daïri's comprehensive statement.

We commend the authorities for the gains made in strengthening macroeconomic stability during the past decade. At the same time, there is ample room for more aggressive steps that would help Morocco realize its growth potential. We share the staff's concerns regarding insufficient growth performance and its implications for unemployment and poverty reduction. While Morocco benefits from large remittances from its workers abroad, it would benefit more from developing home-grown business opportunities. I would like to comment on four issues: structural issues, fiscal, monetary, and the financial sector.

Structural Reforms

Implementation of more ambitious structural reforms could help to enhance productivity, spur private sector activity and investment and thereby accelerate economic growth. In particular, we urge the authorities to ensure the passage and effective implementation of a new labor code which would help to increase labor market flexibility and reduce the high unemployment rate. This issue has been outstanding for some time, and we note the comments of Mr. Daïri this morning explaining some of the reasons for this. We also concur with the staff comments on the importance of enhancing competition and removing barriers-to-entry for new firms. In addition, we welcome the steps taken last year to liberalize foreign trade, particularly the elimination of reference prices as recommended by the WTO. We encourage the authorities to follow through on their plans for further liberalization going forward and to avail themselves of opportunities to expand trade, such as through the trade agreement currently being negotiated with the United States. Finally on the structural side, we welcome the progress made in social indicators, particularly education enrollment rates, as described in Mr. Daïri's statement.

Fiscal Policy

On fiscal issues, we welcome the improvement in the fiscal position in 2002 and are encouraged by steps taken to limit spending, such as a reduction in subsidies, and we urge further efforts along these lines. While we welcome the civil service hiring freeze, there is room for additional savings in the wage bill, which remains high at almost 12 percent of GDP. Hence, civil service reform needs to remain on the agenda. We agree with the comments of Mr. Shaalan on the need to incorporate the special investment fund into the budget, as recommended by the ROSC.

On the revenue side, I concur with the comments of Mr. Ondo Mañe regarding tax exemptions and measures to strengthen tax administration. In addition, we are concerned about the reliance on privatization proceeds to finance the fiscal deficit, both because the sale of Maroc Telecom is somewhat uncertain and because of the effects on longer-term fiscal sustainability. Consistent with the comments of Mr. Kruger, it would be more prudent to seek a reduction in the fiscal deficit and channel privatization funds to debt reduction.

Monetary and Exchange Rate Policy

On the monetary issues, sound policy has helped achieve sustained low inflation. However, as Morocco moves toward further trade liberalization and integration with the international financial system, a more flexible exchange rate regime would allow Morocco to preserve its competitiveness and strengthen its ability to weather shocks. The staff report indicates that 'there is no evidence that the exchange rate is misaligned'. This is a strong statement and suggests that this would be a good time to consider explicit moves to a more flexible exchange rate. Steps to increase the central bank's independence may be needed to facilitate this change, and we are encouraged by the details in Mr. Daïri's statement regarding the draft law to reform the central bank's charter.

Financial Sector

We welcome the comprehensive FSAP review and urge the authorities to publish the FSSA. Efficient financial intermediation and access to credit will help support job creation and lead to stronger economic growth. While the FSSA states that there is little risk of an immediate financial crisis, more effort is needed to increase transparency and address the existing weaknesses in the financial system to limit the emergence of systemic risks. In particular, poor supervision and the lack of a transparent framework to deal with problem banks suggest that financial weaknesses could go unnoticed. The authorities' efforts to date to address the two weak state banks have been far from satisfactory and require a re-examination of the best way forward. Rather than further capital injections, a more permanent solution is needed that should involve either mergers, closures or privatization. Mr. Daïri's statement, for example, describes a six-year restructuring plan for one of the specialized banks. While the plan includes government support equal to 1.5 percent of GDP, it appears not to include privatization. As we have seen in many other countries, state ownership of banks typically leads to weak supervision, bad loan decisions, and repeated public bailouts.

The draft banking legislation provides a window of opportunity to strengthen financial policies, particularly for bank supervision, the role of the central bank, and to define more clearly good governance practices in the banking system. Could the staff comment on the content of this law and the timeframe for its passage?

We welcome the authorities' efforts against terrorist financing and money laundering but urge the authorities to take steps to bring anti-money laundering legislation forward consistent with international standards and establish an FIU.

Finally, we welcome the publication of the staff report. We also encourage the authorities to subscribe to SDDS by yearend, as planned.

Mr. Requin made the following statement:

I would first like to thank Mr. Daïri for his comprehensive statement, which contains a vibrant dialogue with the staff's findings.

Macroeconomic developments have been favorable since 2001, with most indicators (such as growth, inflation, current account position, fiscal deficit) registering positive gains, allowing the country to reap the benefits of the stabilization implemented during the 1990s. 2003 should not mark an interruption in this favorable trend. As observed by Mr. Alazzaz, given the prevailing global environment, these results have to be considered quite favorably, especially as it seems that the war in Iraq did not trigger the negative outcomes we once feared for Morocco. To some extent, Morocco could have benefited from a diversion of tourism flows. Updated comments from the staff on the effects of the war on Morocco's economy would be appreciated. However, these achievements should not lead to excessive complacency as Morocco's growth is still under strain to effectively absorb the growing labor force, while a significant part of current fiscal expenditures are still financed through non-recurrent revenues.

The presently favorable environment could constitute an opportunity for the authorities to strengthen fiscal stabilization (notably to alleviate crowding out effects on private investment) and speed up the pace of structural reforms. While we acknowledge that during the past few years the authorities' efforts have focused on important political issues, we expect the authorities to maintain a sustained commitment to enhance the pace of structural reforms in the coming years. Against this background we note a set of positive signals sent by the new government (including a freeze on civil service recruitment and steps to privatize the national Tobacco company), as noted by Mr. Daïri, regarding the upcoming vote on important laws related to the Central Bank charter and the banking law. Regarding structural reforms, we support the staff's identified priorities (including public sector reform, institutional and market environment initiatives, and labor market reform). I think it is also necessary to outline the importance of improving the education system and professional training, which is actually a government priority. Finally, since the markets of Maghreb countries appear to be quite partitioned, as noted by Messrs. Alowi and Salleh, I would be interested to know the extent to which the staff thinks progress toward regional integration can be achieved in the near term.

While we welcome the authorities' decision to consent to the publication of the Article IV consultation staff report, we are concerned by the possible impact of a refusal to publish the FSSA report on the government's reputation. We wonder if the signaling effects of such a decision would be more harmful than the actual publication of the document, which could be accompanied by comments from the authorities on the thrust of the report, based on Mr. Daïri's observations. We would welcome the authorities' reconsideration of this issue.

On substance, we share the staff's conclusion on the FSAP review: the persistence of financial vulnerabilities, however without the risk of systemic crisis in the short term. We welcome the authorities' intention to cooperate with the staff in order to strengthen banking supervision. The banking sector in Morocco could stand some improvement with respect to its intermediation role. Equity investment stemming from international banks originating from OECD countries could foster know-how transfers and result in an increased role for the private banking sector in economic development. Such an outcome, however, supposes greater transparency from both Morocco's shareholders and supervisory institutions.

Regarding the exchange rate arrangements, I find the staff's arguments in favor of greater flexibility with respect to exchange rate policy quite convincing—enhanced resilience to external shocks, especially as Morocco has traditionally experienced volatile foreign receipts, opportunities for gains in price competitiveness, and fewer obstacles to the lifting of foreign exchange payment restrictions, as well as increased room for maneuver with respect to monetary policy. These developments should, however, be handled with care, as noted in Messrs. Zoccali and Ayala's preliminary statement.

Let me conclude with some positive remarks regarding developments that deserve emphasis in the staff report, which relate to the authorities' performance in external debt management, whose level has fallen from 54 percent of GDP in 1998 to almost 37 percent in 2002. Today, public debt contains favorable features; including increasing domestic content (only 32 percent of the debt is denominated in foreign currency against 75 percent in the early 90s); and, increasing activity in secondary markets, longer maturities (90 percent of the debt maturity is superior to two years, 40 percent to five years) that are not indexed to macroeconomic indicators such as inflation, exchange rates or interest rate. Finally, the remaining foreign debt is highly concessional. These developments have greatly contributed to reducing the macroeconomic vulnerability of the country, as is evident from the loosening of Morocco's sovereign risk spread, which narrowed from 600 bp in December 2002, to around 450 bp in March 2003, as well as recent improvements in S&P's outlook for Morocco, which shifted from negative to stable. The authorities should be commended for these achievements.

With these comments, we wish the authorities success.

Mr. Jang made the following statement:

As staff rightly noted, Morocco's economy has been underperforming over the past decades and continues to be challenged by its high dependence on agriculture, widespread poverty, and high rate of unemployment. Furthermore, we note that the previous government only partially implemented its reform agenda and overall domestic growth was weaker in 2002 than in the previous year. It is therefore clear that it is critical for the authorities to implement prudent macroeconomic policies and accelerate structural reforms in order to ensure a sustainable economic growth.

We will limit our comments to these issues.

First, accelerating structural reforms, geared towards raising productivity and private investment, is critical in sustaining growth and reducing poverty and unemployment. Public sector reform aimed at enhancing efficiency will be an important element in this effort. In this regard, it is noteworthy that the authorities recently completed a Public Expenditure Review is noteworthy, and this will provide a window of opportunity for the authorities to identify expenditure priorities and enhance the effectiveness of social spending. However, the details of the proposed structural reforms are lacking in some other sectors. For example, in paragraph 15, it says that the authorities and industrialists are studying measures to improve the competitiveness of the economy and concrete proposals will be made shortly. What do they mean? If recent history is anything to go by, it will be further tax concessions, particularly since the working group consists of industrialists. Also, what is to be included in the labor code which will free up the labor market? Unemployment is very understated, given the very low participation rate.

We commend the authorities for their increased fiscal discipline as reflected in the reduction of fiscal deficit for 2002. To make this path sustainable and to reduce the debt burden over the medium term, the authorities are encouraged to implement stronger measures on both the expenditure and revenue sides.

On the expenditure side, there is room for further cuts in 2003, particularly in the area of contingency allocations. We welcome the authorities' commitment to maintain the trend toward reducing the high wage bill. Further consolidation of the wage bill would free up resources that can be used to reduce poverty. It is worrisome that the ratio of tax revenues to GDP continued to decline due to the impact of tariff reduction and the erosion of the tax base. While staff advised that an overhaul of the VAT is needed to partially offset the impact of lower taxes, our view is that they need to do more than partially offset, and need to reverse the decline in revenue performance. To this end, what are the authorities' plan for 2003? Are they planning to remove some tax holidays and special exemptions and increase direct taxes? What was the reason for expecting a further decline in tax revenue in 2003. Was it just a very conservative assumption? The last sentence in the second dot point in paragraph 18 says that the authorities agreed that domestic taxes would need to remain at least unchanged as a proportion of GDP from 2002. Rather than being unchanged, they should desirably rise in 2003.

With regard to the financial sector, it is comforting to note that it poses no major immediate risks. The FSAP review mission, however, identified weaknesses requiring urgent attention. Among others, there is a need to address the large state-owned specialized banks. A great deal of effort also needs to be undertaken promptly so as to address the fragility of non-bank financial institutions, particularly the pension fund, and to reinforce financial supervision.

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

Mr. Komatsuzaki made the following statement:

I would like to thank the staff for their analysis and staff paper, and Mr. Daïri for his extensive and informative statement.

While gradually moving in the right direction, the Moroccan economy has yet to achieve a rapid economic growth in order to reduce poverty and unemployment. Obstacles to economic activities remain prevalent, although there have been some welcome developments. In the meantime, stability in macroeconomic management increased, with an improved fiscal position and prudent monetary policy management. It is encouraging to note that the new government is taking a business-friendly and reform-oriented approach in order to remove impediments to growth—financial markets have begun to react favorably to these developments. We urge the authorities to persevere with their reforms.

We agree with the staff appraisal and its stress on structural issues. We would like to make a few additional remarks.

To achieve the authorities' objective of an increase in total factor productivity (TFP) and private sector investment, upgrading of the business environment and labor market are necessary undertakings. A competitive environment that is conducive to the establishment of enterprises promotes entrepreneurship, and flexibility in the labor market, and enables efficient corporate structure. Both are extremely important for TFP growth. A more productive and competitive domestic sector would lessen the authorities' concerns about external competitiveness and trade liberalization, thereby allowing them to continue opening up trade.

Regarding fiscal policy, the consolidation that the authorities have achieved in 2002 is welcome, as it marks a reversal from the decline in the preceding years, and this trend should continue over the medium term. On the revenue side, the revenue base has to be stabilized. We concur with the staff's proposal to broaden the tax base, and to make its structure more transparent, while strengthening the tax administration. On the expenditure side, the containment of the wage bill must continue. Ongoing civil service reform should play an important role here.

The central bank took decisive actions in the face of an abrupt increase in liquidity in 2002 due to external inflows. Going forward, a prudent policy mix of fiscal and monetary policies have to be sought to maintain low inflation without overly dampening economic activity. The role of fiscal consolidation is important in order to ensure that inflation control does not rely too much on monetary policy.

As Morocco gains more access to international financial markets, new issues arise in monetary policy management and governance of the financial sector. With increased integration into international financial markets, risks from the continuation of the fixed exchange rate increase. The issue of the appropriate foreign exchange regime is a complex and sensitive one, but an appropriate way to make the transition to a more flexible regime should be sought. Soundness of the financial sector and adequate capacity in financial supervision has to be ensured so that an external inflow will not lead to an accumulation of risks in the financial sector. In this regard, we welcome the completion of the FSAP review and endorse its recommendations.

The financial sector was modernized gradually during the last decade, but still has much room to expand. There is a large segment of the population that does not participate in the financial system, and financial markets remain shallow. To successfully increase the openness and importance of the financial sector, without hurting macroeconomic stability, implementation of the main FSAP recommendations should precede liberalization efforts. In particular, a systematic way of dealing with troubled banks has to be devised and the supervisory forbearance has to be avoided to maintain the integrity of financial supervision.

With these remarks, I wish the authorities every success.

The staff representative from the Middle Eastern Department (Mr. Lazare) made the following statement in response to questions and comments from Directors:

Mr. Ondo Mañe asked about the measures needed to achieve the medium-term objectives recommended by the staff—i.e., to reduce the deficit to below 3 percent of GDP and to reduce the stock of debt in relation to GDP. Reaching the fiscal target suggested by the staff would require several additional measures. On the revenue side, tax reforms would be needed to improve the VAT legislation, and to enlarge the tax base for both direct and indirect taxes. Strengthening the tax administration and transferring the responsibility for VAT collection to the tax directorate would also be key. Expenditure measures that must be undertaken include civil service reform, which the authorities are actively pursuing with the help of the World Bank. The elimination of food subsidies accompanied by an improved and well-targeted social safety net would also help to reduce expenditures. Furthermore, the recently completed World Bank Public Expenditure Review should help to improve the authorities' ability to rationalize expenditures.

Mr. Ondo Mañe also asked if the staff was recommending that the authorities adopt an inflation-targeting regime. As was indicated in the staff report, a move toward a more flexible exchange rate regime requires a change in the monetary framework involving the use of a nominal anchor. The authorities can choose from many possible anchors, which include money, credit, and inflation targets. However, the staff believes that it is somewhat premature to choose from among these options, which should be studied in greater detail. Moreover, the staff is reluctant to advocate the adoption of an inflation-targeting regime at this juncture, particularly in light of the fact that financial markets in Morocco are still relatively shallow.

A few other Directors also commented on the choice of exchange rate regimes. Again, the staff recommended adopting a flexible exchange rate regime over the medium term. This recommendation is primarily driven by ongoing trade and capital account liberalization, which may have a significant impact on Morocco's equilibrium exchange rate. In this light, the staff is of the view that a fixed exchange rate regime will become less appropriate for Morocco, given the fact that the risk of exchange rate misalignments may increase substantially as liberalization proceeds.

Mr. Kruger observed that the maintenance of capital controls may hold both benefits and disadvantages for the economy. The benefits of such controls include the ability to mitigate the risks associated with possible runs on the currency and capital account crises. The staff agrees with this point, but doubts the long-term effectiveness of capital controls for Morocco or other countries. But indeed, the risks noted by Mr. Kruger call for a cautious approach to the removal of capital controls, which will require a solid macroeconomic framework, further fiscal consolidation, and further strengthening of the financial system. The staff will also continue to study these issues, as has been the case in other countries such as Tunisia.

Mr. Requin asked about the possible consequences of the war in Iraq for the Moroccan economy. At this time, the staff has not developed a quantitative estimation of these impacts. However, it seems that this impact will be fairly limited, as tourism receipts have not been particularly affected by the conflict; although preliminary indications suggest that there has been a small reduction in tourism in March. Oil price increases have also proven relatively moderate. Thus, the overall impact of the conflict on the balance of payments should be modest. Similarly, we expect that there will be only a moderate impact on the level of growth, and that any negative fallout can be offset by higher than predicted agricultural production. Precise figures for agricultural production will be available in May, but it is likely that agricultural production will prove higher than estimated so far, and the staff is thus hesitant to revise downward its 5.5 percent real growth projection.

Mr. Jang asked a number of questions about tax revenues. There does seem to be a small drop in tax revenues for 2003, owing primarily to further trade liberalization in the context of the implementation of the Association Agreement with the EU. Furthermore, the projected increase in agricultural production, which is not taxed, will cause tax revenues to drop relative to GDP, everything else being equal.

Regarding the dialogue between the private sector and the government on competitiveness issues, the staff is unable to predict the possible outcome of this ongoing discussion. However, as noted in the report, the staff advises that no special tax incentives should be provided in the context of this dialogue.

Regarding revenues for the first two months of 2003, the staff's projections for the beginning of the year seem to have been surpassed. It is somewhat premature to project this trend over the rest of the year, but there are possible upside risks for revenue growth relative to the revised projections included in the staff report and those contained in the budget.

The staff representative from the Monetary and Exchange Affairs Department (Mr. Durand), in response to a question from Mr. Baukol on the likely content of the draft banking law and the time frame for its passage, pointed out that the latest version of the draft law had incorporated the majority of the recommendations made by the staff during the

FSAP review mission. The proposed law significantly increased the powers of the BAM, particularly in the area of crisis management. Drafters of the law also envisioned the creation of a coordinating body in which all financial supervisors would be represented. Regarding the schedule for the ratification and implementation of the law, Mr. Daïri had noted that the draft would be considered by the government without delay and subsequently transmitted to Parliament.

Mr. Daïri made the following additional statement:

Mr. Requin asked about regional cooperation in the Maghreb. There are some positive developments on the political level as far as relations between Morocco and Algeria are concerned. We are very optimistic at this juncture, although, so far, there is no major breakthrough in this area. On this occasion, I would like to thank the Managing Director for his personal involvement and the staff for their hard work in promoting regional cooperation and the elimination of obstacles to trade, including through a meeting in Paris and missions in Rabat, Algiers, and Tunis.

Regarding the dialogue with the business sector, two agreements have been signed by the government with the textiles and tourism professions. These agreements commit both parties to improving growth and export performance in the two sectors, but the budget impact of these agreements is not very high. However, Fonds Hassan II has contributed to land development for tourism and textile industries, which are faced with significant shortages.

Finally, regarding the fiscal stance over the past two years, there is no indication that privatization revenues have led to increased spending or an increase in the deficit, as I mentioned in my statement. The overall deficit, excluding privatization revenue has declined over the past two years, and the ratio of total expenditure to GDP has declined significantly. Revenue performance has not been as good as expected, but the authorities are serious about trying to reverse these trends through tax reforms and improved administration.

Ms. Wolff made the following statement:

Like other speakers let me first thank the staff for a set of well-written reports, and Mr. Daïri for his comprehensive statement. At the outset, we would like to congratulate the authorities for their achievements in democratization and on political reforms. With progress on political reforms and an improved short-term outlook, they now have the opportunity to focus on economic reforms to boost growth, lower unemployment, and alleviate poverty. We encourage the authorities to forcefully implement further structural reforms and to follow up on fiscal restraint to ensure a sustainable fiscal position. We deduct from Mr. Daïri's statement that the authorities are very aware of what needs to be done and that they are on the right track.

As most issues have already been raised and we generally agree with the staff's assessment, I will try to be brief, and to focus my comments on three issues for emphasis.

Regarding structural reforms, progress to date not withstanding, we agree with other speakers that further reforms of the public sector are important in order to foster private sector activity. Therefore, we encourage the authorities to take additional steps in order to reduce government intervention and regulation, improve the delivery of public services, and further strengthen the business environment to boost private investment. In addition, bold reforms of the labor market will be essential. Also, like other speakers, we encourage the authorities to proceed with trade liberalization.

Second, on fiscal policy, we welcome the improvement in the fiscal position in 2002, an election year. Still, we agree with the staff that stronger measures are necessary on both the revenue and expenditure sides. On the expenditure side we concur with the staff's specific proposals to end the subsidization of sugar and flour consumption – after due compensation for the poor, as underlined by Mr. Kruger, to reduce allocations for contingency spending, and to maintain the trend toward reducing the public wage bill. On the revenue side, especially reform of the VAT is needed to offset the impact of lower external tariffs on customs collection and to phase out tax holidays and special exemptions on direct taxes. Furthermore, we strongly support the staff's advice to implement a medium-term strategy aimed at bringing the deficit down under 3 percent of GDP and to reduce the public debt to significantly below 60 percent of GDP. Again, as other speakers noted, this is especially important when considering the fact that privatization proceeds will be phased out over the medium term.

Third, on monetary and exchange rate policy and financial sector reform, we commend the central bank for its prudent monetary and exchange rate policies. We support the staff's recommendation to consider introducing a more flexible exchange regime over the medium term and to encourage the authorities to prepare the ground for an eventual change, particularly by achieving and safeguarding a sustainable fiscal position and by strengthening the financial system, including bank and non-bank financial supervision along the lines of the FSSA recommendations. We are encouraged to hear that the authorities have already started to address the weaknesses in financial supervision.

Finally, we also welcome the authorities' consent to the publication of the staff paper and we wish them further success in tackling the challenges that they are facing.

Mr. Varela made the following statement:

I would like to thank the staff for the documents they prepared for today's discussion. I found the FSSA report particularly interesting, as it highlights the main challenges facing the authorities with respect to stability and the development of the Moroccan financial system. I would also like to thank Mr. Daïri for his comprehensive statement.

The Moroccan economy has shown considerable resilience over the last few years. After a period of slow growth in 1999 and 2000, the growth rate has returned to high levels, despite difficult international and domestic circumstances, including a severe drought, rising oil prices, a global economic slowdown, and geopolitical tensions. In this context, the authorities have continued to implement sound macroeconomic policies and have made progress with structural reforms. Many Directors welcomed the authorities' achievements in terms of low inflation, the current account surplus, low external debt levels, and growing official reserves. Nevertheless, the authorities must continue to undertake reforms aimed at promoting sustainable grow rates of above 5 percent per year.

Regarding the staff's short-term outlook, we believe that it seems rather optimistic, particularly in light of the uncertainties associated with the conflict in Iraq. This seems to be a case where both the virtues and limitations of the Fund's country surveillance exercises are evident. The Moroccan authorities have been implementing generally prudent fiscal and monetary policies, and have made substantial efforts to advance structural reforms. The question now is whether these measures are sufficient to promote sustainable growth and development. This is obviously a reflection of both the country's sources of growth and the degree to which the Fund can identify and promote key policy measures that might have a significant and lasting impact on the structure and performance of the economy.

Fiscal and monetary policies could be adjusted further, but we must not overlook the authorities' prudent policies and economic management over the past several years. Nevertheless, the staff is right to call for further fiscal consolidation in 2003, and we support further spending adjustment in order to bring the fiscal deficit down in 2003. Furthermore, we agree with the staff and Messrs. Zoccali and Ayala that a medium-term fiscal strategy must be developed in order to underpin macroeconomic stability and foster private sector activity. We encourage the authorities to continue the reform of the civil service and to undertake additional measures aimed at containing the wage bill. We also support the staff's suggestion to modify the VAT to make it more efficient and equitable.

Regarding monetary policy, the authorities must be commended for their skillful policies thus far, particularly regarding liquidity conditions and the exchange rate. We agree with the staff and several other Directors that the peg of the Moroccan dirham to a basket of currencies has served the economy well. Nevertheless, we fully agree with the staff that the government should consider moving toward a more flexible exchange rate regime, in which policy is focused on the inflation rate or some other monetary aggregate, once the authorities have met the prerequisites outlined by the staff.

The staff suggests that there are no signs of a misalignment of the exchange rate. However, we had hoped that some additional and more recent information could have been included in the staff report regarding Moroccan exports, particularly recent trends and distributional data. Furthermore, the authorities should continue to promote incentives for both private and foreign investment, including through the reform and liberalization of labor markets and policies aimed at increasing flexibility and competitiveness. Such measures are prerequisites for the creation of a dynamic private sector that is capable of competing with foreign entities both at home and abroad.

The staff has identified a number of areas where the authorities should concentrate their efforts, including addressing the vulnerabilities of the financing sector, increasing the flexibility of labor markets, promoting the modernization of the private sector, opening the economy through trade liberalization, and establishing a business-friendly environment. We support these priorities, and we encourage the authorities to proceed with their reform agenda now that the new legislature has been assembled. However, we acknowledge that the authorities are right to continue to emphasize the delivery of social services and poverty reduction, particularly with respect to education and health care.

Regarding the financial sector, we are reassured by the main conclusions of the FSSA regarding the soundness of the commercial banks, and the fact that the financial sector is not a source of macroeconomic risks. Nevertheless, we encourage the authorities to address the sector's remaining vulnerabilities, especially with respect to financial supervision and transparency. With these remarks, we wish the authorities success.

Mr. Litman made the following statement:

I would like to commend the staff for a well-written report, and to thank Mr. Daïri for his insightful statement. In 2002, the Moroccan economy grew by 4.5 percent, despite the slow growth of its export markets, and the reduction in tourism that followed the events of September 11. In that year, growth was led by increased agricultural production, both for domestic use and for export. Furthermore, the autumn rains, which initially caused widespread damage, will improve the 2003 harvest. Increasing agricultural incomes should also increase private consumption, and strong growth in construction should contribute to improving growth performance. The prompt end to the war in Iraq should also help to quell concerns over security in Morocco, which will surely provide a boost to the tourism sector.

I agree with the staff that the main challenge facing the government is to reduce unemployment and poverty through economic growth. The staff note in their report that there is 20 percent unemployment in urban areas; 35 percent unemployment among people from 15 to 44 years old; and, 26 percent unemployment among graduates. While it is encouraging to note that a quarter of a million jobs have been created since September 2002, much remains to be done. I was encouraged to hear that Prime Minister Jattou presented a new reform program to the Parliament in November 2002, where he acknowledged that the government's plan to address unemployment through the expansion of the public sector had failed. He subsequently emphasized that the only way to reduce unemployment, improve living standards, and eradicate poverty, would be to create an environment that is conducive to raising the rate of sustainable economic growth.

During its first months in office, the government implemented some of its planned reform measures. Chapter 4 of the staff report notes that there was an agreement between the authorities and the staff over a wide range of policies. In previous discussions, this chair supported the pegged exchange rate, and is therefore pleased to hear that the staff now believes that the fixed rate no longer constitutes an impediment to a high rate of economic growth.

Regarding the fiscal deficit, while I usually support the staff's recommendations to lower fiscal deficits, the staff's recommendation to reduce food subsidies should not be implemented immediately. As Mr. Daïri noted in his statement, the authorities' performance was better in recent years than the staff's initial estimations suggested. Moreover, the existing fiscal deficit has not spurred inflation, and the central bank has skillfully managed to provide abundant liquidity and low interest rates. Furthermore, these low interest rates have not hampered economic activity, and the current account is in surplus, while the levels of external reserves remain high. Therefore, I agree with Messrs. Shaalan and Kanaan and Mr. Kruger, and cannot support the staff's recommendation to cut food subsidies. I thus support the authorities' intention to reduce the fiscal deficit gradually until it reaches a target of 3 percent of GDP by 2003. Nevertheless, I urge the authorities to monitor the situation closely and to remain prepared to react promptly if the situation changes. Thus, I would appreciate some clarification from the staff as to why they recommend a reduction in the allocation of contingency spending in paragraph 19 of the staff report, and whether this is a new feature in the budget.

Regarding the VAT, I support the staff's recommendations, and urge the authorities to simplify the VAT scheme by decreasing the number of rates, increasing coverage, and limiting exemptions.

With respect to insolvent banks, I believe that it is sometimes advisable to exempt financial institutions from prudential regulations during the process of restructuring. To facilitate this process, the exemption should be transparent, transitory, and not create an unfair competitive advantage for the entity in question. As these criteria seem to have been met, according to Mr. Daïri's statement, I would appreciate additional comments from the staff as to why they recommend that insolvent banks be forced to comply with prudential regulations. With these remarks, I wish the authorities success.

Mr. Lissovolik made the following statement:

We thank the staff for an insightful report on Morocco, which in our view captured the most essential priorities and exigencies that the country is facing at the present juncture. The confluence of an exchange rate peg, high public debt and fiscal deficits certainly raise concerns about the economic viability of the economy as it opens up to the world. At the same time, it does appear that in recent years significant progress was made in advancing economic reforms as well as reducing external vulnerabilities, and the Moroccan authorities deserve credit for these important advances.

On the fiscal front, while the overall fiscal deficit and level of public debt appear high, there are factors that attenuate the concerns over these fiscal parameters. Firstly, there is the favorable structure of the country's domestic debt, which, as underscored by Mr. Requin, is rising in importance compared to external indebtedness—about 90 percent of domestic debt is now tradable (up from 70 percent three years ago) and about 90 percent has a maturity of 2 years or longer (40 percent is 5 years or longer). With respect to external debt, early repayment of higher coupon obligations has contributed to reduced public external debt service. Notwithstanding the above considerations, which together with other factors make the requirement of fiscal surpluses in the short-term supererogatory, we agree with Mr. Shaalan and Mr. Kanaan that fiscal policy should aim at steadily reducing the budget deficit to 3 percent of GDP in the medium term, with the target of 4 percent of GDP serving as a guide for the current fiscal year.

In the monetary sphere, the authorities have reacted in a timely fashion to ongoing developments, with the rising role of the sterilization instruments in mopping up excess liquidity serving to attenuate inflationary pressures. Looking further ahead, like the French chair and Mr. Varela we agree with the staff on the merits of devising an exit strategy from the current arrangement to a flexible exchange rate regime consistent with lowering external vulnerability.

Like Mr. Shaalan and Mr. Kanaan, as well as Mr. Baukol and Ms. Wolff, we commend the authorities for the important progress made in trade liberalization and we urge Morocco's authorities to complement these reforms with a more comprehensive reduction in the external tariff.

As rightly pointed out by the staff, the liberalization of Morocco's economy to the outside world raises the bar for the economy's resilience to external vulnerabilities, which in turn necessitates pro-active structural reforms, most notably in the financial sphere. We are pleased with the results of the FSAP review exercise and its contribution to raising the awareness amongst the country's policymakers of the risks concentrated in the financial sector.

In the social sphere, we take note of the progress made by Morocco in improving its social indicators as detailed in Mr. Daïri's helpful statement. We hope that the authorities will build on these successes to markedly cut poverty levels, which remain high. Another important challenge facing the authorities is the high unemployment rate, and in this respect the adoption of a Labor code that is more conducive to labor market flexibility will be viewed by many as a test of the authorities' readiness to implement unpopular, but much needed measures. Market integration, including via greater labor mobility, will be an important factor in transcending the limits to growth of Morocco's dual economy.

On the whole, the outlook on Morocco is improving of late. In February of this year Standard and Poor's moved from negative to stable outlook on its BB rating for Morocco. Market expectations are for Moody's to follow suit and move to a stable outlook for Morocco on its BAL rating. The latter is expected to result in an amelioration of the country's access to the world financial markets, with some of the market observers already setting their hopes on the launching of the long-awaited inaugural Eurobond.

Also, the assessments of the fallout from the war in Iraq in the private sector are very much along the sanguine lines expounded in Mr. Daïri's statement, which is conducive to easier access to external financing and FDI on the part of Morocco. Notwithstanding past achievements and improved prospects in the future, the current priority for Morocco is to forge ahead with structural reforms and a macroeconomic adjustment that reduces the country's external vulnerability. In this process the staff is very much on target in emphasizing the need for careful sequencing of the relevant packages of macroeconomic reforms as lucidly described in paragraph 48 of the staff report.

With these remarks we wish Morocco's authorities success.

Mr. Prasad made the following statement:

We thank the staff for an excellent set of reports and Mr. Daïri for his helpful statement. Recent macroeconomic performance indicators, the external sustainability analysis, the smooth political transition management, and the subsequent reform initiatives point to Morocco's resilience to shocks and its capacity to forge ahead on a sustainable growth path. We commend the authorities for these achievements, particularly for increasing business confidence and containing inflation despite the devaluation. We hope that the authorities can keep this momentum up by creating an enabling environment for increased private investment—both domestic and foreign.

Measures to further liberalize trade are encouraging. The long list of legislative enactments and the creation of a conduce environment for barrier free trade indicate the broad political support for this reform agenda, which is aimed at establishing transparent regulations, predictable policies and competitive markets in Morocco. We note that the banking sector is generally sound, and has managed abundant remittances and provided liquidity for the economy. We are encouraged by the ongoing efforts to strengthen banking supervision. These efforts need to expand the financial sector as a whole.

We generally agree with the staff assessment of required reforms to reinvigorate economic growth over the near and medium terms, and we are happy to note that the Moroccan authorities' share this assessment. However, we would like to offer a few additional comments.

We feel that in order to continue the recent impressive economic transition against domestic and external constraints, the authorities need to make a dent on poverty with at least 5-6 percent real GDP growth on a sustainable basis. Therefore, the challenge before the authorities while facing the odds from vested interests, is to leverage fiscal and monetary policies for intensified implementation of the structural reforms to modernize public sector, to attract private investment for economy-wide efficiency gains, to absorb increasing unemployment, to diversify the growth sources, to raise total factor productivity, reduce the fiscal deficit, and to insulate the economy from the adverse impact of fluctuations in the agricultural sector, while ensuring food security. The need to implement the reform plan and fiscal consolidation need not be overemphasized as the aggressive implementation of reforms could accelerate growth leading to an increase in investment to about 26 percent of GDP.

To some extent, the external risks associated with regional tensions and increasing oil prices are waning. The actions already taken by the authorities in lowering the wage bill, reducing subsidies, and improving the social safety net, in our view, demonstrate the commitment to reform. With these comments, we would like to wish the authorities continued success.

The staff representative from the Middle Eastern Department (Mr. Lazare), in response to Mr. Litman's question on contingency expenditures, noted that most Directors had agreed with the staff that further fiscal consolidation was needed over the medium term. The staff was of the view that the fiscal deficit for 2003 would have to be lower than the previous year in order to ensure credibility of the authorities' medium-term fiscal consolidation strategy. That would require good tax revenue performance, and indications had been promising for the first few months of the year, although it was clear that additional measures were needed, including a reduction in contingency expenditures. The staff had received in the days preceding the Board meeting a breakdown of contingency expenditures, which indicated that a significant proportion of the available funds had already been earmarked, but also that a limited amount—on the order of 0.1 to 0.2 percent of GDP—could have been used to tighten the fiscal stance. Nevertheless, the authorities seemed to have demonstrated a firm commitment to fiscal consolidation and a tight fiscal stance in 2003, which suggested that a 4 percent of GDP deficit target for 2003 was achievable.

Mr. Daïri made the following statement:

> As indicated by Mr. Lazare, the truly unallocated expenditure is about 0.1 or 0.15 percent of GDP, which will be used to face contingencies such as natural disasters. The country is subject to natural disasters, and it is necessary to be prepared to face such situations. Last year, for example, we had some of the worst flooding in recent history, the main oil refinery—which accounts for 80 percent of the market—was completely burned down. I would like also to indicate that prior to 1998, the government could pay for additional wage costs without them being budgeted. In 1998, the rule was changed, and since then there is no possibility for the government to effect such spending. The new rule ensures that the total budget—including unallocated expenditure—is not exceeded. There is not much room for savings here because basically all the spending is already identified except for this 0.10 to 0.15 percent, which is allocated for contingency purposes.

The Acting Chair (Mr. Aninat) asked Mr. Daïri if the authorities would publish the FSAA report.

Mr. Daïri made the following concluding statement:

> I have noted the interest expressed by several Directors on the issue of the possible publication of the FSSA report. Of course, this is a voluntary endeavor. However, I will convey the interest expressed by these Directors to my authorities, who have not yet decided on this issue; but I hope they will take a positive attitude in this regard.
>
> I would also like to thank Executive Directors for their interest and support, and management and the staff for their hard work. I will faithfully convey Executive Directors' comments and recommendations to my

authorities. I can reassure the Board that the authorities are extremely attentive to the views of the Fund, in particular, of the Board, and I am certain that they will do their utmost to meet their demanding challenges

The Acting Chair made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the Moroccan authorities for maintaining macroeconomic stability despite adverse weather conditions and a difficult international environment. Inflation was kept well under control, non-agricultural output accelerated, official foreign exchange reserves rose to comfortable levels, and both the fiscal deficit and the debt-to-GDP ratio declined. Progress with structural reforms in recent years includes, among others, the modernization of the customs administration, the privatization of public enterprises, the liberalization of the edible oils sector, telecommunications reform, and trade liberalization in accordance with the Association Agreement with the European Union.

Notwithstanding these achievements, Directors agreed that Morocco's growth performance remains insufficient to generate a significant decline in unemployment and poverty, and that its fiscal position needs to be further strengthened. They therefore welcomed the new government's resolve to accelerate the pace of structural reform and private sector development in a context of continued macroeconomic stability and fiscal consolidation. Directors were encouraged that the reform measures which the government has taken in its first months in office have already resulted in an improvement in business confidence and market perception, and looked forward to further confidence building measures in the period ahead.

Directors urged the authorities to build on recent progress by taking further actions that will signal a durable strengthening of Morocco's fiscal position. They recommended a reduction of the fiscal deficit to about 4 percent of GDP in 2003 and to below 3 percent of GDP over the medium term, consistent with a further substantial decline in the public debt-to-GDP ratio. Directors welcomed the authorities' decision to broadly stabilize the number of civil servants in 2003, and encouraged them to carry on with a comprehensive civil service reform that will allow a further reduction of the wage bill over the medium term. This should include a review of the remuneration and promotion system, and the establishment of an early retirement scheme. To help offset revenue losses resulting from the ongoing trade liberalization, Directors also stressed the need for streamlining VAT and direct tax exemptions, as well as tax incentives, and strengthening the VAT administration.

Directors recommended that the authorities take steps toward further reducing food subsidies, while at the same time ensuring that an adequate safety net is put in place to alleviate the impact on the poor. More broadly, they were of the view that developing a medium-term expenditure strategy would help improve prioritization as well as the quality and effectiveness of key public services, including health and education spending. A few Directors encouraged the authorities to consider the consolidation of the Hassan II fund's operations with the central government budget accounts. A few Directors also suggested that the authorities should channel future privatization proceeds toward debt reduction.

Directors underscored the importance of sustained structural reforms in a wide range of areas, and supported, in this context, the priority given by the new government to public sector and judiciary reform, strengthening governance, improving the business environment, and labor market, trade, and financial sector reforms. They welcomed the actions already taken to liberalize the land transportation sector and to integrate public enterprise pension schemes in the public pension system, as well as the work being undertaken in several other areas. Directors urged the authorities to press ahead with their reform agenda, and, in this context, looked forward to rapid progress on the new labor code. They also encouraged the authorities to maintain their commendable record on trade liberalization, including by lowering and rationalizing the multilateral external tariff.

Directors welcomed the recent steps to improve the business environment, and the close consultation with the private sector on further measures to improve the competitiveness of the economy (mise à niveau). Going forward, it would however be important to avoid special incentives and/or tax privileges that could distort the allocation of resources.

Directors noted that Morocco's financial system is unlikely to be a source of risk in the short term, and that the commercial banks are in a reasonably good position to withstand adverse shocks. The recent FSAP review has nevertheless revealed vulnerabilities which require the authorities' close attention, especially in light of increasing international integration. Directors welcomed the preparation of a revised legislative framework to help address these weaknesses. They urged the authorities to press ahead with their plans to deepen financial sector reforms, in particular in the area of banking supervision for which the Fund is providing technical assistance. Another priority is the acceleration of the restructuring of the troubled specialized banks, and the elimination of their exemption from prudential regulations and reserve requirements, while, over the medium term, further reducing the role of the state would foster the competitiveness of the financial sector. Directors also encouraged the authorities to press ahead with adequate legislation and provisions to prevent money laundering and the financing of terrorism, in line with international standards.

Directors commended Bank Al-Maghrib's skillful monetary management, which, by mopping up excess liquidity, has been instrumental in keeping inflation at a low level, and looked forward to upcoming legislation that will strengthen the Bank's operational independence. They observed that Morocco's exchange rate policy has so far served the country well by providing a helpful nominal anchor, and that there are no signs of a misalignment of the exchange rate. Directors discussed the medium-term challenges for monetary and exchange rate policy posed by Morocco's increasing trade and financial integration, and were generally of the view that a more flexible exchange rate regime would improve Morocco's resilience to external shocks and growth prospects. They welcomed the authorities' willingness to consider the opportunity of modifying the current exchange rate regime and the role of monetary policy over the medium term, once the prerequisites of a strengthened monetary framework with price stability as the primary objective, further fiscal consolidation, and an enhanced financial sector are achieved, and encouraged careful further analysis of all issues involved.

Directors commended the authorities' efforts to improve transparency and governance in the public sector, and looked forward to further progress in these areas. They also welcomed their intention to further strengthen the statistical system in line with recent ROSC recommendations, with the objective to subscribe to the Special Data Dissemination Standard by end-2003.

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

3. WTO ATTENDANCE—INVITATION TO ATTEND EXECUTIVE BOARD MEETING

Length: 5 minutes

The Executive Directors invited a WTO representative to attend the upcoming meeting of the Committee on Liaison with the World Trade Organization.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/03/38 (4/25/03) and EBM/03/39 (4/28/03).

4. TWO BUSINESS DAY VALUE DATE FOR USE OF CURRENCY IN OPERATIONS AND TRANSACTIONS BETWEEN THE FUND AND A MEMBER—SAME BUSINESS VALUE DATE FOR LATE AND UNSCHEDULED PAYMENTS

Paragraph 1 of Decision No. 5590-(77/163) shall be amended to read as follows:

"1. The exchange rate for computations by the Fund relating to the currency of a member in the General Resources Account.

(a) on the occasion of the use of that currency in an operation or transaction between the Fund and a member (other than the case specified in (b) below) shall be the rate determined as of the date of the Fund's instructions for the execution of the transaction or operation, and if this rate cannot be used, the rate of the preceding day closest thereto that is practicable. The value date shall be the second business day after the date of the dispatch of the Fund's instructions, or as early thereto as is practicable.

(b) Payments received by the Fund after the due date and payments made to the Fund on an unscheduled basis shall be valued at the exchange rate in effect on the day of receipt, provided that, if a late payment is received within ten business days from the date of the instructions and there is a shortfall or overpayment caused by the difference between the exchange rate used for the instructions and the exchange rate in effect on the day of receipt, no adjustment shall be made if the shortfall or overpayment does not exceed SDR 5,000, unless the member that issues the currency being used for the payment requests that the adjustment be made irrespective of costs.

(c) on all other occasions shall be the rate at which the currency is held by the Fund." (EBS/03/54, 4/18/03)

Decision No. 12998-(03/39), adopted
April 25, 2003

5. VALUE DATE FOR EXCHANGE OF CURRENCY—AMENDMENT OF RULE O-6

Paragraphs (b) and (c) of Rule O-6 of the Fund's Rules and Regulations, on the value date for an exchange of currency, shall be amended to read as follows:

> "(b) The exchange rate for each currency for the purposes of (a) above shall be determined as of the date of dispatch of the Fund's instructions for the execution of the transaction or operation under (a) above, and if this rate cannot be used, the rate of the preceding day closest thereto that is practicable.
>
> (c) The value date for an exchange of currency under (a) above shall be the second business day after the date of the dispatch of the Fund's instructions under (b) above, or as early thereto as is practicable." (EBS/03/54, 4/18/03)

Decision No. 12999-(03/39), adopted
April 25, 2003

6. PAYMENT DAY FOR CHARGES—AMENDMENT OF RULE I-2

The last sentence of Rule I-2 of the Fund's Rules and Regulations, on payment of charges, shall be amended to read as follows:

> "The charges shall be payable on the second business day following the dispatch of the notification." (EBS/03/54, 4/18/03)

Decision No. 13000-(03/39), adopted
April 25, 2003

7. VALUE DATE FOR PAYMENT OF SPECIAL CHARGES

The second sentence of Paragraph V, Section 1 of Decision No. 8165-(85/189) G/TR, on the payment of special charges, shall be amended to read as follows:

> "The charges shall be payable on the second business day following the dispatch of the notification." (EBS/03/54, 4/18/03)

Decision No. 13001-(03/39)G/TR, adopted
April 25, 2003

8. VALUE DATE FOR SETTLEMENT OF SDR TRANSACTIONS BY AGREEMENT—AMENDMENT OF RULE P-6(a)

The second sentence of Rule P-6 (a) of the Fund's Rules and Regulations, on the settlement of transactions in SDRs by agreement, shall be amended to read as follows:

> "Settlement shall take place on the date of the agreement or any business day within two business days from that date, as agreed between the participants." (EBS/03/54, 4/18/03)

Decision No. 13002-(03/39), adopted
April 25, 2003

9. CUT-OFF TIME FOR PROCESSING OF REQUESTS FOR PURCHASES—AMENDMENT OF RULE G-4(a)

The second sentence of Rule G-4 (a) of the Fund's Rules and Regulations, on the issuance of instructions for a purchase, shall be amended to read as follows:

> "Except when the Executive Board decides otherwise, instructions for a transfer of currency shall be given by the Fund on the day of its decision approving the purchase, unless such decision has been taken after the close of the business day, in which case instructions shall be given not later than the close of the first business day following the decision." (EBS/03/54, 4/18/03)

Decision No. 13003-(03/39), adopted
April 25, 2003

10. CONTRIBUTIONS TO PRGF AND PRGF-HIPC TRUSTS—VALUE DATE FOR OPERATIONS AND TRANSACTIONS

All operations and transactions under borrowing agreements, administered accounts or in connection with any other form of contribution to the PRGF Trust and the PRGF-HIPC Trust shall be changed to a two business day valuation rule. (EBS/03/54, 4/18/03)

Decision No. 13004-(03/39)PRGF, adopted
April 25, 2003

11. SUPPLEMENTARY FINANCING FACILITY SUBSIDY ACCOUNT—EXCHANGE RATE FOR PAYMENT OF SUBSIDIES

All pending subsidy payments under the Supplementary Financing Facility Subsidy Account shall be made on the basis of the SDR/U.S. dollar exchange rate in effect two business days before the payment date, and, if this rate cannot be used, the rate of the preceding date closest thereto that is practicable. (EBS/03/54, 4/18/03)

Decision No. 13005-(03/39)SBS, adopted
April 25, 2003

12. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, by Advisors to Executive Directors, and by Assistants to Executive Directors as set forth in EBAM/03/50 (4/24/03) is approved.

APPROVAL: August 13, 2003

SHAILENDRA J. ANJARIA
Secretary