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EBS/92/180
Correction 1

CONFIDENTIAL

November 24, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Mauritania - Staff Report for the 1992 Article IV Consultation and Request for Arrangements Under the Enhanced Structural Adjustment Facility

The following corrections have been made in EBS/92/180 (11/13/92):

Page 10, 2nd full para., lines 1-4: for "Iron ore exports...new gold mine."
read "The exchange rate...new gold mine."

Last three lines carried over to page 11.

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

the context of a structural adjustment operation to be prepared with assistance from the World Bank and other donors. The actual stock of arrears of the commercial banks, and the portion of those unpaid obligations insured on the creditors' side, will be established definitely after completion of both the audits of the banks (November 15, 1992) and data reconciliation with the export insurance agencies of Mauritania's main creditor countries. In the meantime, the Central Bank and/or commercial banks have approached creditors to initiate the process of arrears settlement.

Mauritania maintains controls on the sale of foreign exchange for imports and for invisible transactions. In 1991 the annual limit on the foreign exchange allocation for travel was raised from UM 10,000 to UM 20,000; for business travel, the limits range from UM 100,000 to UM 800,000 based on the applicant's turnover, and bona fide requests for higher amounts for travel may be granted on a case-by-case basis. These restrictions are maintained by Mauritania under the transitional arrangements of Article XIV of the Fund's Articles of Agreement. At the same time, the Government has accumulated arrears on external debt payments.

In addition, a multiple currency practice subject to approval under Article VIII, Section 3 arises from the existence of a preferential exchange rate for transfers from Mauritanian workers residing overseas. The authorities have decided to replace this preferential exchange rate by the free foreign exchange market rate as of January 1, 1993, and to direct future reforms of the exchange system toward the unification of the official pegged rate and the free market rate. Meanwhile, the two-tier exchange system also involves a multiple currency practice.

In order to move toward a market-based exchange rate, a limited market for foreign currency notes and travelers' checks was introduced in late October at the level of the commercial banks, where the rate is freely determined. Purchases of foreign exchange in the free market would be on a "no questions asked" basis and, beginning on March 31, 1993, sales will be made without limits for bona fide payments for invisible transactions (e.g., travel, medical, and educational expenses). A pegged exchange rate will be maintained for the time being for transfer of foreign exchange through the banking system for all other transactions; it will be kept under review, taking into account a broad range of indicators (including movements in the free market rate, developments in the import authorization auctioning system and the external sector), and adjusted as necessary.

To facilitate the proper management of foreign exchange resources, the Central Bank will prepare monthly foreign exchange cash-flow statements beginning on January 1, 1993, and conduct a monthly auction of import authorizations. Authorizations are to cover gradually all imports and give automatic access to foreign exchange, once the authorization has been obtained through the auction. Also, in order to ensure that foreign exchange is available to support the recovery of the fishing sector, the Central Bank, in conjunction with the commercial banks, will establish before the end of 1992 a revolving letter of credit facility with a correspondent bank. Finally, prior export authorizations will be eliminated, except for security, health, or cultural reasons.

(ii) Balance of payments

With the adjustment of the exchange rate and the tightening of financial policies, the external current account deficit (excluding official transfers and the largely self-financed imports of equipment required to develop the new iron mine) is expected to narrow, to somewhat over 12 percent of GDP in 1992 and to some 7.5 percent in 1993 (18 percent of GDP in 1992 and over 11 percent in 1993, including imports related to the SNIM mining project).

The exchange rate adjustment is expected to have a favorable impact on fish export earnings in 1992. Nonetheless, export earnings are projected to fall by nearly 3 percent. The decline of iron ore exports by almost one fifth due to the softening of world demand and prices is expected to more than offset the increase in fish exports and the modest contribution to export earnings by the coming on stream of a new gold mine. The effect of the exchange rate adjustment on import demand, on the other hand, is expected to be negligible this year, because of speculative stockpiling of consumer goods and intermediate products in the first three quarters of the year and increased imports of equipment related to the public investment program and the SNIM project. Net transfers are expected to jump by one half, reflecting, inter alia, a steady inflow of workers' remittances in response to the above-mentioned exchange rate differential for those transactions. Even with a turnaround in net capital inflows, traceable largely to higher loan disbursements for SNIM, the overall balance of payments deficit is expected to remain unchanged, at the equivalent of SDR 87 million in 1992.

In contrast, the exchange rate correction and strengthening of macroeconomic and structural policies would have a strong impact on the balance of payments in 1993. Export growth is projected at more than 13 percent, as the fishing sector would respond to the exchange rate action and pelagic fleet operations are normalized. Weak world demand would prevent any significant recovery in the value of iron ore shipments, but gold exports are expected to more than double. At the same time, an abrupt fall in consumer goods imports and in imports for public investment (as most of the projects envisaged in the 1989-91 public investment program approach completion) should cause total imports to decline by 7 percent, despite a modest prospective recovery in energy and intermediate goods imports as GDP growth gains momentum. Payments for services should level off on account of lower interest payments, but transfers are expected to fall slightly as the preferential exchange rate is eliminated. Net capital flows are expected to turn negative again on account of lower disbursements for SNIM and the fall in public investment outlays.

Given the need to eliminate external payments arrears and the objective of raising gross official reserves to about 1.7 months of imports, the gross financing gaps would approach SDR 180 million in 1992 and SDR 185 million in 1993 before external debt relief, use of Fund resources, and program-related assistance from the World Bank and other donors. These gaps take into account the settlement in cash in 1993 of the portion of commercial banks' arrears on short-term debt that are insured on the creditors' side (some SDR 32 million on August 31, 1992). The remaining balance (about SDR 85 million) is expected to be restructured within the context of the sectoral adjustment operation prepared with World Bank and other donor assistance. The Government is requesting rescheduling on enhanced concessional terms of arrears and current maturities falling due on pre-cutoff-date medium- and long-term debt, as well as on previously rescheduled debt, from Paris Club and other bilateral creditors. Given the expected debt relief as well as program-related loans from the World Bank (including cofinancing) and other donors, the financing gaps for 1992-93 would be fully covered.

The authorities intend to pursue a prudent debt management policy by strictly limiting the amount of nonconcessional borrowing contracted or guaranteed by the Government in the 1- to 15-year maturity range, excluding debts contracted in the context of rescheduling agreements. The stock of short-term borrowing by the commercial banks, other than normal import-related credits, will also be strictly limited. Both of these variables will constitute benchmarks for the entire period of the first annual arrangement, except those for end-March 1993 which will constitute performance criteria.

d. Structural policies

To strengthen the response of the economy to the correction of the exchange rate and facilitate the diversification of the productive base, a number of structural reforms in key sectors are to be implemented during the program period with assistance from the World Bank. The private sector initiative program, which will be prepared in collaboration with the World Bank, will address the restructuring of the fishing sector and the banking system, where existing structural weaknesses have constrained private sector investment as well as output growth. These reforms, which are detailed in the PFP, include also a land tenure reform, the adoption of appropriate development technologies for the management of natural resources, the establishment of a viable rural credit system, and the implementation of an emergency water supply program to meet the needs of agriculture. In the fishing sector, the Government will promote small industrial enterprises, while ensuring that the catch remains compatible with the preservation of the resource base. Artisanal fishing will be promoted through appropriate tax and credit policies. In the public enterprise sector, the monopolies of the Mauritanian insurance and reinsurance company (SMAR) and of the tea imports of the import/export company (SONIMEX) will be abolished. The Government will also sell 50 percent of the capital of the fish marketing agency (SMCP) to the private sector by December 31, 1992.

In the regulatory area, the Government intends to maintain a liberal regime. However, controls have had to be reimposed temporarily over the prices of seven imported commodities, as well on two locally produced goods, in an effort to counter speculative price movements and diffuse social unrest in Nouakchott in the wake of the October devaluation. Measures have been taken to break monopolistic practices by importers, and to increase access to import trade by simplifying the conditions for qualifying as an importer. In addition, the commercial banks have been instructed to limit to two months the maturity of new loans to the private sector for financing stocks of imported goods. The price control measures, however, are meant to be temporary. The prices of the locally produced goods and of two of the seven controlled imported goods were freed on November 15, 1992, and those of the remaining five imported goods will be decontrolled by December 31, 1992. As for other administered prices, tariffs for water and electricity will be adjusted in two steps, starting with an increase of 16 percent effective November 1, 1992, followed by a second hike of the same magnitude by the end of the year. The retail prices of petroleum products were increased effective October 6, 1992 to levels comparable to those in the region.

3. Social dimensions of the adjustment program

Mauritania's adjustment strategy aims both at raising the standard of living of the population and at reducing poverty. With the sustained implementation of the reforms envisaged in the program, the recovery in private sector activity is expected to enhance employment opportunities and raise real incomes over the medium term. In the short run, however, the accelerated divestiture of public enterprises, the restrictions on new employment in the civil service, and the prospective restructuring of the banking system will all result in some hardship for various groups in the population. To address these transitional costs, the authorities have prepared a number of measures, 1/ to be coordinated by a "special impact unit" at the Ministry of Planning. In addition, a food-for-work program has been established with assistance from the United Nations Development Program (UNDP).

A poverty profile will be finalized by end-1992. Additional survey work is also under way to assess the socioeconomic impact of adjustment, notably on retrenched civil servants and nomadic populations, and help in formulating policies and programs to protect the most vulnerable groups, increase their productivity, and restore their income-earning capacity. The Government is also planning to create new jobs through a public works project to be carried out through small- and medium-sized enterprises. In addition, with effect from 1993, the Government intends to increase gradually budgetary allocations for primary health care and education. Initiatives will also be taken to facilitate the re-entry into gainful private

1/ The timetable for the implementation of these policies is provided in the matrix attached to the PFP.