INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/158

10:00 a.m., December 6, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	G. C. Noonan
	Zhang Z.
	C. S. Warner
J. de Groote	
	L. B. Monyake
	S.-W. Kwon
	P. O. Montórfano, Temporary
	G. Montiel, Temporary
	N. Kyriazidis
	S. K. Fayyad, Temporary
	M. Pétursson
	O. Kabbaj
G. Grosche	
	S. P. Shrestha, Temporary
	L. E. N. Fernando
	L. M. Piantini
J.-P. Landau	
Mawakani Samba	
	M. Al-Jasser
	G. P. J. Hogeweg
	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
D. J. de Vos, Assistant

Also Present

IBRD: B. T. Ngo, Africa Regional Office. African Department: E. L. Bornemann, Deputy Director; J.-C. K. Brou, S. E. Cronquist, R. E. Daumont, P. Dhonte, S. M. Nsouli, D. J. Ordoobadi, C. D. Pham, P. A. Youm. Exchange and Trade Relations Department: A. Basu. Fiscal Affairs Department: J. Baldet. Legal Department: H. Elizalde. Secretary's Department: A. Tahari. Advisors to Executive Directors: J. O. Aderibigbe, Z. Iqbal, N. Toé. Assistants to Executive Directors: H. S. Binay, C. Björklund, A. Fernandez, M. A. Hammoudi, J. Heywood, P. Kapetanovic, H.-J. Scheid, J.-P. Schoder, G. Serre.

1. SENEGAL - 1989 ARTICLE IV CONSULTATION, AND ENHANCED STRUCTURAL ADJUSTMENT FACILITY - SECOND ANNUAL ARRANGEMENT

The Executive Directors considered the staff report for the 1989 Article IV consultation with Senegal and the member's request for a second annual arrangement under the enhanced structural adjustment facility (EBS/89/218, 11/15/89; and Cor. 1, 11/21/89), together with a policy framework paper (EBD/89/357, 11/14/89). They also had before them a background paper on recent economic developments in Senegal (SM/89/250, 11/27/89), and a statement by the Managing Director, which read as follows:

The Managing Director made the following statement:

There follows for the information of the Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on December 1, 1989:

1. The Executive Directors met as a Committee of the Whole on December 1, 1989, to consider the policy framework paper, 1989/90-1991/92 for Senegal. The Executive Directors generally commended the Government of Senegal for its sustained efforts in implementing macroeconomic adjustment. They noted many positive results of the various reforms undertaken thus far, with the support of the Bank and of the Fund. The Directors noted, however, that as a consequence of a series of events, many outside the control of the Government, Senegal had experienced lower economic growth and a difficult financial situation in 1988/89. The Directors supported the program objectives for the coming three years and commended the Government for maintaining its commitment to a number of difficult reforms that could be expected to get growth back on track and have a significant impact on rationalizing public expenditure, increasing revenue, and removing bottlenecks to growth in the private sector.

2. In addition, the Executive Directors raised a number of concerns which fell broadly into five categories as follows: (a) long-term growth prospects and competitiveness of the economy; (b) improvement in the financial position of the Government and public sector reform; (c) exchange rate; (d) environmental degradation; and (e) adequacy of measures to mitigate the social costs of adjustment.

3. The Executive Directors expressed concern regarding future growth prospects and the competitiveness of the economy, particularly in view of the importance of evoking a significant supply response from the private sector. In this regard, the Directors

drew attention to the seemingly high projected rates for output and export growth. The staff said that prospects for increased growth from the low base of 1988/89 were good and that such growth could be sustained. The Government had demonstrated its determination to undertake difficult reforms aimed at reducing the costs of factors of production, especially for energy, and at increasing labor market flexibility for industry, where legislative actions had recently been taken. The effort to further improve the incentive framework through the introduction in the policy framework paper period of a major tax reform and of measures to improve the regulatory environment was also noted by the Directors. The staff noted that export growth projections were based on a moderate expansion in volume and on the present outlook of an increase in international prices for Senegal's main export commodities.

4. The Executive Directors were concerned that the stabilization effort should be sustained and that the shortfalls in revenue experienced in 1988/89 should not imperil the Government's financial position and thus its commitment to the reform program. They noted that actions needed to be taken to strengthen the revenue collection services, notably the customs and tax administrations, and that reforms of direct and indirect taxes were needed to improve domestic resource mobilization. The need for technical assistance to help in the design and implementation of these reforms was raised. Finally, they stressed the importance of the Government's undertaking the proposed measures to control the growth of public expenditure, notably through the rationalization of the civil service and the reduction in the wage bill, and through the reduction of subsidies to aid greater efficiency in public enterprises. The staff noted that the process of divestiture of parastatals had recently accelerated and that the Government was to adopt specific targets for privatization and liquidation of enterprises under the proposed fourth structural adjustment loan.

5. The Executive Directors raised the issue of the relationship between the real exchange rate and the achievement of private sector growth and external payments objectives. The staff noted though that Senegal's adjustment program had taken into account its membership in the West African Monetary Union and the CFA franc zone. The demand-management and fiscal policy measures enacted by the Government had contributed to a real effective exchange rate depreciation since 1986. Measures aimed at cost reduction in the Government's program for the next three years would help solidify this trend and increase Senegal's external competitiveness.

6. The Executive Directors stressed that economic policies to be pursued for the three-year period ahead should contribute actively to arresting environmental degradation. They noted

the increased attention the Government was to pay to this matter, as indicated in the policy framework paper.

7. Some Executive Directors expressed reservations concerning the adequacy of measures to deal with the social dimensions of adjustment, particularly urban unemployment, which would be aggravated by the employment reductions in the civil service and the parastatals. The staff noted that significant progress has been made since the establishment of an Employment Fund in December 1987 to address this problem. This effort has since been expanded through the design of new, innovative job creation programs, which are to be supported by the Bank through the proposed Public Works and Employment Project.

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

Substantial progress has recently been achieved in the discussions between the World Bank staff and the authorities on the fourth structural adjustment loan (SAL IV), which is expected to be considered by the Bank Executive Board in January 1990. Two reform elements supported by the SAL IV are the reduction in labor market rigidities and the restructuring of the civil service. With regard to the labor market, legislation has been approved providing employers with greater flexibility in dismissing employees, exempting certain categories of firms and their income tax contribution from part of the payroll tax, in order to reduce effective labor costs, and permitting the firms that are expanding their operations to hire employees under temporary contracts for indefinite periods. With regard to the civil service, a plan of action has been elaborated to reduce the size of the civil service by about 10 percent over a three-year period, through a voluntary departure program involving incentives in the form of appropriate separation benefits.

The staff of the Fund has been in close contact with the authorities on the evolution of the fiscal situation during 1989/90 July/June. All the revenue measures envisaged in the program for first half of the fiscal year have been taken already, and the cumulative revenue target through end-October 1989 is reported to have been achieved. The authorities have also pursued a tight expenditure policy, maintaining expenditure below the programmed level. Nevertheless, because of a delay in the receipt of external financial assistance, the Treasury encountered cash-flow problems, which resulted in an accumulation of payments arrears, including on debt service obligations to the Bank. The authorities have now settled their arrears to the Bank. Furthermore, they have informed the Fund staff of their intention to continue to defer all low-priority expenditure and to sustain their intensified revenue mobilization efforts with a view to eliminating all their external debt payments arrears and to observing the performance criteria for end-December 1989.

The authorities have also reported that they suspended at end-November 1989 the operations of two small private banks, the Banque Sénégalo-Koweitienne (BSK) and Massraf Faycal Al-Islami du Sénégal (MFIS), and that they will place these banks in receivership by end-December 1989 if the private shareholders are unable to provide sufficient resources to restructure the banks. Furthermore, the authorities have concluded negotiations with the Bank staff on a comprehensive reform program for the banking system. To support these reforms, a financial sector adjustment credit is scheduled for consideration by the Bank Executive Board on December 19, 1989.

Mr. Mawakani made the following statement:

My authorities are in broad agreement with the staff appraisal and have no major difficulties with the policy recommendations contained in the staff report.

Contrary to the high expectations raised in March during the midterm review of the 1988/89 program under the first annual arrangement (EBM/89/37, 3/20/89), the performance of the Senegalese economy for 1989 turned out to be mixed. While performance in terms of the rate of inflation, the external current account deficit, and structural reforms remained on target, real GDP growth and the fiscal and monetary objectives of the program could not be achieved. As explained in the staff report, this outcome was the result of adverse developments in the second half of 1988/89, which made the attainment of some of the program's targets an elusive undertaking.

On the one hand, the rate of inflation, as measured by the GDP deflator, declined to 1.9 percent, against the 2.4 percent programmed; and the external current account deficit, excluding official grants, was further reduced from 10.2 percent of GDP in 1987/88 to 9.6 percent of GDP in 1988/89; and tangible progress was made in the overall implementation of structural reforms. On the other hand, real GDP grew by only 0.6 percent, compared with the 4.2 percent programmed, and the overall fiscal deficit--on a commitment basis and excluding grants--increased from 2.6 percent of GDP in 1987/88 to 4.0 percent of GDP in 1988/89, instead of decreasing to 1.8 percent of GDP, as targeted under the program. Thus, the steady progress that the authorities had been making under their adjustment program was abruptly interrupted in 1988/89, underscoring the fragility of the gains achieved to date, and the need for the authorities' continued perseverance and vigilance in the pursuit of the objectives of their medium-term strategy.

Undaunted by the setback suffered in 1988/89, the authorities have reassessed their adjustment strategy, revised the program's quantitative objectives and, where necessary, have strengthened and deepened their policies in order to restore the momentum of adjustment and to make further progress toward achieving their medium-term objectives. Consequently, in close collaboration with the staffs of the Fund and the Bank, they have updated and extended their original medium-term policy framework paper to cover the period 1989/90-1991/92. The basic objectives and the policy strategy under the medium-term program are spelled out in the policy framework paper (EBD/89/357), and need no further elaboration.

In line with this medium-term framework, the 1989/90 program has been designed to achieve real GDP growth of 4.6 percent, to contain the rate of inflation--as measured by the GDP deflator--to 2.0 percent, and to reduce further the external current account deficit, excluding official grants, to 8.3 percent of GDP.

In view of the weakening of the fiscal adjustment in 1988/89 brought about by the sharp fall in government revenue, the authorities have tightened their financial policies so as to reduce the overall fiscal deficit--on a commitment basis and excluding grants--to 2.8 percent of GDP, from the 4.0 percent of GDP recorded in 1988/89. Moreover, they remain committed to pursuing the implementation of structural reforms throughout the economy.

In the fiscal sector, a number of revenue-raising measures have been included in the 1989/90 budget. These measures are expected to yield additional budgetary receipts, equivalent to 1.9 percentage points of GDP. They include a rationalization of the value-added tax on imports, with the base being broadened and the rate being reduced from 50 percent to 30 percent; an extension of the withholding tax scheme for general income tax to cover professional and property income; and an across-the-board increase in the customs duty rate. In an effort to stem the decline in import duties resulting from underinvoicing, the authorities have established minimum tax assessments for import items subject to such practices, and have computerized customs procedures and improved customs control. On the expenditure side, to compensate partially for the slight wage adjustment for civil servants after the five-year salary freeze, an increase of 2.5 percent on average, the authorities intend to reduce civil servants' fringe benefits and appropriations for subsidies and transfers. In line with their medium-term objective of reducing the share of the wage bill in total expenditure, and based on the recommendations of the studies completed in September 1989, the authorities have adopted in principle the objective of reducing the size of the civil service by about 10 percent over a three-year period through a voluntary departure program. Discussions are under way with the World Bank and other donors to provide financing for the program.

With regard to the reform of the public enterprise sector, my authorities recognize that progress has been slower than they would have liked, particularly in the privatization process. They wish to emphasize, however, that the delays experienced in the privatization program were mostly beyond their control, and traceable to legal and administrative problems and to the lack of investors. They hope that the creation of a secondary market for the shares of the enterprises to be privatized would help accelerate the privatization process. In any event, the Government plans to privatize 35 enterprises and to liquidate 10 others during 1989/90-1990/91, and has indicated its intention to liquidate those enterprises that would not have been privatized by the end of the period.

In the monetary sector, where much progress has been accomplished in reforming the banking system, the authorities are addressing the situation of the three banks that have experienced difficulties, and are proceeding with the restructuring of five public banks. Pending the adoption of a final decision at the end of the year, the operations of the BSK and the MFIS have been suspended as of end-November 1989, while the rehabilitation of the Banque Internationale pour L'Afrique de l'Ouest-Senegal (BIAO-S) is proceeding well. Overall, it should be stressed that the reform of the banking sector is expensive, costing an estimated CFAF 200 billion. With the central bank (BCEAO) providing about two thirds of this amount, through the consolidation of nonperforming loans at concessional terms, the authorities hope that the negotiations under way with interested parties for the financing of the balance could be concluded expeditiously and that the financial assistance would be provided on concessional terms.

As far as the implementation of structural reforms in the agricultural and industrial sectors is concerned, the authorities are greatly encouraged by the progress made, and are determined to continue their efforts. In this regard, they are working closely with the World Bank to secure a structural adjustment and an agricultural sector adjustment loan. Furthermore, following the modification of the investment code in October 1989--with a view to introducing more flexibility in employment and wage policies--the authorities have decided to allow enterprises to resort to fixed-term employment. Also, a decision has been adopted to freeze minimum wages of industrial workers at existing levels. In addition, the Government has adopted a plan of action aimed at reducing energy costs to the industrial sector. In the groundnut sector, the authorities intend to finalize a medium-term plan of action with the objectives of further lowering groundnut marketing and processing costs and of streamlining the refining operations of the groundnut oil processing company (SONACO). More importantly, a new protocol will be concluded between the Government and SONACO to ensure transparency in the latter's financial operations.

I wish to reiterate my authorities' commitment to the comprehensive adjustment program initiated in 1983. This commitment has been reinforced in view of the setback suffered in 1988/89, which served as a reminder that, despite the substantial progress achieved over the past five years toward attaining Senegal's medium-term objectives, there is no room for complacency. As pointed out by the staff in its appraisal, Senegal is at a critical juncture in its adjustment process. My authorities are well aware of this, and have accordingly taken courageous measures at the inception of the program to ensure optimal conditions for its implementation. As the staff rightly indicates, the success of the authorities' efforts will depend also on the timely flow of external financial assistance. Indeed, this will be of critical importance to helping alleviate the short-term effects of the adjustment process. To this end, in collaboration with the UNDP, UNICEF, and other bilateral donors, the authorities are conducting extensive studies whose results and recommendations will enable them to formulate corrective measures to protect the most vulnerable social groups. In the meantime, the authorities have established an employment fund to facilitate the reinsertion of the groups most affected by the adjustment process.

Mr. Landau made the following statement:

As underlined in the staff report, Senegal's economic recovery remains a delicate process. Owing to a combination of adverse agronomic conditions and social disturbances, growth has been disappointing during the 1988/89 period. However, the drop in export receipts has been offset by lower than expected imports, which has allowed the current account deficit to be maintained in line with the program's target at 9.6 percent of GDP. Moreover, the overall implementation of the first annual arrangement under the enhanced structural adjustment facility has been unfolding satisfactorily in the areas of structural reform, and government expenditures and credit policy, with all relevant benchmarks and performance criteria having been met. In contrast, fiscal revenue has remained far below program objectives, resulting in a suspension of internal arrears settlement. This shortfall is due to a severe drop in customs receipts, attributable mainly to insufficient customs monitoring and to a diminution in sales tax volume--linked to civil unrest and the development of the informal sector. The overall fiscal deficit on a cash basis has been contained as programmed, and has been covered by exceptional rescheduling through the Paris Club.

Against this background, the new arrangement rightly focuses on improving public resource allocation and on the pursuit of structural reforms aimed at enhancing the private sector and thereby allowing a resumption of growth at an average rate of 4 percent during coming years.

The Government must clearly regain tighter control of its resources, all the more since the fiscal revenue target already in place is extremely ambitious, with a targeted increase of 18 percent above the outturn in 1988/89. Taking into account the outlook for groundnut and cotton production, I wonder whether the fiscal revenue objective is realistic. I am more comfortable with the measures aimed at broadening the fiscal base and at reinforcing customs receipts, although Directors have to bear in mind that those measures will not bear their full impact in early 1990. We thus urge the authorities to give their utmost priority to implementing the revenue package under the program in a timely and adequate manner. Moreover, concerning nontax revenues, we agree with the staff on the necessity of increasing SONACO's revenue contribution, to offset partially the Government's subsidies to the Price Equalization and Stabilization Fund (CPSP), and the risks involved in the reform of the petroleum sector. We are also pleased to acknowledge the authorities' prudent stance of modifying the tax system before changing the petroleum price structure--to prevent further shortfalls in revenue.

On the expenditure side, the reduction in the share of the wage bill, to be achieved through curtailing the number of civil servants, will be crucial. We hope that the ongoing negotiations with the World Bank and other donors will lead to an agreement on the matter as soon as possible. This action, as well as the continued pursuit of the austerity measures in the current program, will enable additional resources to be allocated to recurring structural expenditures.

We agree with the staff that the momentum of public enterprise reform needs to be accelerated further. The recent slowdown in the implementation of the program must be addressed quickly; in particular, the authorities should give their utmost attention to concluding performance contracts for the rehabilitated strategic enterprises.

Enhancing the private sector's confidence through a comprehensive set of structural reforms remains critical. We welcome the authorities' willingness to promote market-oriented measures in order to eliminate price distortions and to improve resource allocation for both the agricultural and industrial sectors. We also commend the authorities for the recently approved measures to improve the link between remuneration and productivity, and to address the rigidities in the labor market and factor cost. In this regard, the action plan launched to restructure energy taxation and prices is encouraging as well as the initiative taken to restore the activity of Dakar's free trade zone.

Senegal has made progress thus far in the West African Monetary Union in fostering both the financial intermediation necessary to pursue a credit policy aimed at meeting the growth requirement of the economy and to contain the rise in aggregate demand. We hope that the ongoing restructuring of the banking system will be scheduled in line with the next World Bank sectoral adjustment credit, so that additional resources may supplement the external assistance foreseen in this area.

I commend the authorities for their prudent management of the external debt, which has allowed Senegal to benefit from the Toronto Summit rescheduling terms and from bilateral debt forgiveness. Moreover, the discussions with commercial banks have led to encouraging progress on debt rescheduling, and to further debt swaps. In consideration of the next Paris Club rescheduling, which will take place in early 1990, I would like to point out that settling all pending arrears in due time would be useful means for the authorities to maintain the confidence of the international financial community in Senegal.

I am pleased to note that, owing to the progress already achieved under the program, Senegal's external position is projected to continue to improve, as demonstrated in the staff's medium-term scenarios. However, such progress will need to be sustained by timely disbursements of external assistance. The program's continued success will undoubtedly depend on the authorities reinforcing the far-reaching structural reforms implemented already and on the maintenance of the tight fiscal policy. The authorities' determination merits the support of the international financial community. We support the proposed decision.

Mr. de Groote said that he agreed with the staff's conclusions and that he could support the proposed decision. It was surprising, however, that Senegal, although a long-term user of Fund resources, had experienced a constant decrease in public revenues, from about 13 percent of GDP in 1983 to about 19 percent of GDP at present. While one could understand the reduction of revenues in 1988, given the drought and its effects on agricultural production and given the periodic social unrest, it was difficult to explain that trend over the longer term. Of course, the reduction in government revenues during a period of economic growth indicated clearly the development of an informal sector; indeed, there had been a substantial transfer of resources in Senegal from the formal sector to the informal sector. The staff could usefully comment on any envisaged measures in terms of taxation and fiscal income, for bringing the formal sector back under the general supervision of the authorities. It was important that the authorities increase their fiscal revenues to a level commensurate with the country's need to pay debt obligations and with its important responsibilities in developing infrastructure. Also, as Senegal was a country in which the public sector accounts were not highly transparent, he wondered about the justification for the special accounts of the Treasury. Did those accounts make the achievement of monetary targets more difficult?

When a Fund-supported adjustment program was implemented, it was usual to observe a proliferation of cross-sector debt between parastatal enterprises and the development of cross-sector parastatal accounts, Mr. de Groote noted. The background paper on recent economic developments had noted that there were not many statistics on that question in Senegal, which he found regrettable. Nonetheless, he would be interested to know from the staff whether the development of those intersectoral debts made the achievement of the monetary and liquidity targets more complicated. Was the staff assured that its monetary target adequately covered the monetary aggregate, or was that aggregate, in effect, being absorbed in the intersectoral debt between parastatals?

While the staff papers did not contain much information on direct investment, it did appear that such investment had not grown, which was a surprising fact for a country that had a highly liberalized payments system and a low rate of inflation, Mr. de Groote continued. Was the low level of direct investment due to bureaucratic difficulties or to the fear of further increases in wage costs? Had the authorities envisaged specific measures for correcting the situation?

As had been noted in the discussions on Benin (EBM/89/75, 6/16/89) and Cameroon (EBM/89/156, 12/1/89), it was interesting that, although a highly effective control of monetary and credit aggregates had been developed in the CFA franc zone, a parallel development of banking supervision had not taken place, Mr. de Groote observed. While the staff had pointed out that banks had been reorganized in Senegal, was that reorganization sufficient for establishing appropriate control of banking activities, and was the staff satisfied with the existing mechanism for bank supervision, particularly for credit allocation? There was always a danger in a developing country such as Senegal that credit would be rationed on the basis of criteria other than the economic.

Mr. Warner made the following statement:

Senegal has implemented a wide-ranging macroeconomic and structural reform program in recent years, which has liberalized the economy, increased growth, and strengthened government finances. The slippages that occurred in 1988/89 are all the more regrettable in light of the past successes, and will hopefully prove to be temporary. For this to be so, the authorities must reinforce and sustain their efforts in the context of the second annual arrangement under the enhanced structural adjustment facility.

In particular, we are concerned about the loss of momentum in fiscal adjustment, with the budget deficit on a commitment basis having been much higher than programmed. In recent years, prudent fiscal and financial policies have contributed to an environment that has produced an impressive record in terms of increased domestic savings and a resumption of private capital inflows. Maintaining the confidence of private savers and investors will require continued strengthening of the Government's financial position. In this context, more aggressive implementation of tax reform measures will be necessary to develop a more stable source of revenue. The staff's indication that the revenue measures contained in the program have been implemented is welcome news. In addition, the Government's ability to restrain current expenditures will depend importantly on reducing the level of the public sector wage bill, which currently accounts for more than half of current expenditures. We are concerned about the slow pace in reducing public employment, and were pleased to learn that agreement has been reached on measures to reduce the size of the civil service by 10 percent over three years. However, we would appreciate additional information from staff on the cost of the separation benefits, how they will be financed, and what further measures are contemplated to prevent further wage drift in the public sector.

The authorities' ability to keep inflation under control is a major success and reflects both a cautious fiscal stance and an aggressive interest rate policy. However, the need to raise rates--owing to international considerations--may have exacerbated the effects of the slower growth caused by the problems in the agricultural sector. In these circumstances, a more flexible exchange rate system may have eased the adjustment burden both domestically and internationally.

A key element of Senegal's reform efforts is the reduction of the Government's involvement in the industrial sector. The authorities have shown considerable courage in implementing reforms in the agricultural and banking sectors. We are concerned, however, about the continuing delays in reforming the public enterprises. The Government's support for these enterprises is a substantial drain on resources that could be better utilized elsewhere. We urge Senegal to accelerate the pace of reform and privatization. In this connection, we would have preferred the inclusion of a specific timetable for privatizing public enterprises during the second annual arrangement, rather than a commitment to further study.

Senegal will require continued substantial external resources over the next few years to finance key domestic reforms and the current account deficit. These resources have been provided in the past, and prospects for continued support are good, provided Senegal sustains its economic performance. In this connection, we are disturbed that the program seemed to have gone off track during the second half of 1988/89, after Fund resources were disbursed. Such action can only raise doubts in the minds of official donors regarding Senegal's commitment to lasting reform. A sustained reform effort will be needed to reduce external financing requirements and to provide a sound basis for increased growth.

We commend Senegal for the strong reform effort that has been undertaken in the past, and which compares very favorably with experience in other countries in the region. We hope that the recent setbacks prove temporary, and urge the authorities to act forcefully, and on a sustained basis, to restore the earlier momentum achieved.

Mr. Enoch made the following statement:

Senegal's performance under its first annual arrangement under the enhanced structural adjustment facility has been mixed. As the staff notes, the authorities implemented the program effectively and scrupulously until the beginning of 1989. Since then, while the economy has faced a number of damaging external shocks, policy implementation has slipped and the program has been blown considerably off track.

Despite these problems, the authorities have generally worked hard to maintain the momentum of structural reform. Their most notable achievement has been to restore financial discipline to the key groundnut sector. Significant progress has also been achieved in liberalizing the regulatory framework. Moreover, price controls have been removed in most sectors, and considerable groundwork has been laid for re-establishing the viability of the banking sector.

Notwithstanding these achievements, the staff is right to stress that Senegal's adjustment program has reached a critical stage. Senegal has been a heavy and prolonged user of Fund resources over recent years. Indeed, the country has had an almost uninterrupted sequence of Fund programs over the last decade. Yet despite this long-term commitment on the part of the Fund, the economy seems no nearer than before to achieving external viability. And despite the far-reaching structural measures implemented by the authorities in this period, the economy remains fragile and critically dependent on concessional assistance from abroad. Furthermore, the baseline scenario in the staff paper assumes continued buoyant export prices, good weather, no recurrence of the locust infestation, and an abatement of social disturbances. This scenario may well not be a central case, and the staff's sensitivity analysis shows how vulnerable the economy remains to different external circumstances.

The main positive development over this period, which stands in stark contrast to the experience of other low-income African countries, is the strong increase in domestic saving. What is particularly impressive in Senegal's case is that this positive trend in saving has been the result not only of improved public sector financial discipline, but also of a strong growth in private sector saving--reflecting the importance of positive real interest rates, and the existence of a relatively well-developed financial sector. Furthermore, significant rises in domestic savings are projected through the program period.

Unfortunately, the sustained increase in domestic saving has not been matched by a similar increase in fixed investment; indeed, the staff's figures reveal that private sector investment as a proportion of GDP was lower in 1988 than in 1980, while public sector capital formation was broadly unchanged over the same period. The impact of this failure to raise investment and the apparent absence of any shift in the capital output ratio are reflected in the staff's cautious medium term growth projections, which suggest that, even if the authorities implement the new program meticulously, real incomes will barely outpace the growth in the population over the medium term. In these circumstances, the central objective of the program should be to increase both the volume and efficiency of private sector investment, by maintaining a firm macroeconomic environment, by improving financial intermediation, and by removing the remaining distortions and rigidities that impede the efficient allocation of the country's slender resources.

Against this background, I will make a few comments on the proposed program. First, the authorities must re-establish firm macroeconomic control, after the fiscal and monetary slippages and significant capital flight seen earlier in 1989. While revenue collection was clearly hampered by adverse exogenous developments, it is also clear that there were significant delays in implementing a number of important tax measures in the second half of the financial year, despite the emphasis placed on this issue by Directors at the time of the first program review (EBM/89/39, 3/20/89).

The concrete measures included in the program to raise revenue are welcome, and it is encouraging to hear that the end-October 1989 revenue target appears to have been met. Nevertheless, it is regrettable that the main focus will again be on raising taxes on foreign trade. As far as the import tax regime is concerned, I was interested in the staff's view that the rationalization of the system of effective protection has now been completed. The description of the import tax regime contained in the background papers suggests that different imports are still taxed at very different rates. Has this complex of rates and taxes been simplified? More specifically, has the three-tiered tax structure--comprising customs duty, fiscal duty, and the value-added tax--been consolidated? I was pleased to see the introduction of monthly tax revenue targets which, if not achieved for two successive months, will trigger negotiations with Fund management. I would also welcome an assurance from the staff that the new legislation exempting certain firms from part of the payroll tax and income tax will not adversely affect overall revenue in the second half of the year.

Alongside improved revenue collection, the authorities should focus on two other objectives in the fiscal sphere. First, the public sector wage bill must be brought into line with what the economy can afford, which will require some tough decisions by the authorities. The fact that wage payments account for half of total government consumption underlines the need for decisive action in this area. It is notable, for example, that even the minimum civil service wage is nearly double Senegal's per capita income level. The fact that farm incomes fell in 1988/89 by over a quarter in real terms reinforces the urgency of addressing the civil service wage issue, if an exodus to the urban areas is to be averted. It is reassuring that a plan of action has been designed to prune the civil service over the next three years. However, I understand that some of the civil servants departing under the scheme are to receive lump sum payoffs equivalent to five years' salary. Could the staff confirm that this retrenchment will actually yield net cost savings over the next few years?

The second area where reform is needed urgently is in the complex system of extrabudgetary and earmarked accounts. These special and correspondent accounts erode budgetary discipline and financial accountability, while obscuring underlying trends in revenue and expenditure. I would urge the authorities to move to a more transparent system, by fully integrating these accounts into the budget.

The authorities have a clear agenda of structural policy reform, comprising the re-establishment of a viable and responsive financial sector, an acceleration of public enterprise reform, and a strengthening of efforts to deregulate the economy. While monetary sector reform appears to be progressing well, the authorities' divestiture program has again been pursued with a disappointing lack of vigor.

I was unable to get from the staff's papers a clear idea of how many enterprises have been liquidated and privatized since the inception of the reform program in 1985. Nor could I find any information on the aggregate losses of the nonfinancial enterprise sector over the past five years. More specifically, I note that 62 enterprises were identified for divestiture in 1985. Are the 35 enterprises earmarked for privatization in the next two years additional to this original group, or did the initial plans fall through? I would be grateful for a further clarification of the authorities' record and intentions in this area. I would also be interested to have more information on the nature and scope of the performance contracts under preparation for 8 public enterprises. As in the case of Cameroon, it appears that these contracts will specify detailed annual targets for, inter alia, output and productivity. Does the staff believe that this "hands-on" approach is consistent with an effort to commercialize the sector?

The authorities' public enterprise reform program should be seen in the wider context of the need to deregulate private sector activity and to ensure that the economy remains competitive in world markets without recourse to generous and distortionary export subsidies. A key element in this ongoing reform is continuing price and wage liberalization. In this context, it is clear that while significant progress has already been made, there is still considerable scope for further liberalization. For example, I note that retail petrol prices have been held constant for several years, despite the large swings in world prices; indeed, it is encouraging that reform is planned in this area, since energy costs play a key role, particularly in the industrial sector. As far as agriculture is concerned, the slow projected growth of imports depends critically on a major cut in imports of rice. In that context, I note that the authorities are simultaneously reducing the retail price of rice and hoping for an increase in domestic rice production. I would be interested in how secure the staff considers the prospects for increased rice production and for containment of imports.

Perhaps the most pervasive distortions in Senegal lie in the highly regulated and rigid labor market practices. Again, it is encouraging to read that steps are being taken to make the labor market more responsive to economic developments. However, I understand that the 1962 Labor Code remains in force. Is this likely to circumscribe progress in this area?

Senegal's economy was buffeted in 1988/89 by a series of unwelcome external shocks. The authorities have had to rephase the adjustment program, and a return to external viability has once again been postponed. If Senegal is to move toward external viability, the authorities can no longer dodge some difficult issues. The program supported by the enhanced structural adjustment facility must be fully implemented, if a basis is to be laid for sustained growth over the medium term. I can support the proposed decision.

Mr. Al-Jasser made the following statement:

It is unfortunate that, in 1988/1989, adverse weather conditions and civil disturbances disrupted the commendable adjustment process of the preceding four years. I am glad to note from the statement of the staff representative that, through end-October, the revenue target has been met, while expenditures were below target. This augurs well for the Government's credibility in stabilizing the economy. However, it is a matter of concern that the authorities allowed slippages in tax administration and did not implement further the planned tax measures, which weakened the fiscal position. If net foreign financing had not increased, this policy stance would have worsened the external accounts and further weakened prospects for long-term growth. The abrupt worsening of economic conditions following the recent exogenously caused setbacks well reflects the fragility of the Senegalese economy. The medium-term balance of payments outlook remains tenuous, and growth prospects--even under the optimistic scenario--are modest at best.

I am in general agreement with the staff appraisal and firmly believe that, without a sharp and durable improvement in the public sector's finances and without structural reform, Senegal cannot hope to attain a self-sustaining growth path. In this context, revenue mobilization must be accorded high priority and tax administration must be strengthened. In view of Senegal's good track record, I hope that external financial assistance and debt relief will continue to be available to sustain the needed structural transformation of the economy. I also sincerely hope that exogenous factors, which derailed the adjustment process in 1988/89, will not recur in the future.

Senegal, like all other members of the West African Monetary Union, has assigned an additional burden to fiscal and incomes policies in order to achieve internal and external objectives, with the exchange rate being viewed as an anchor.

Under the current circumstances, when uncertainty has caused private capital flight, and financial imbalances have worsened, the incomes policy may have to carry an inordinately large burden, with possible adverse short-term implications for the achievement of social objectives. The program pins great hope on labor reforms and containment of wage increases for enhancing the competitiveness of the industrial sector. In the absence of recent data on returns to labor and other factors of production, and also on cross-sectoral comparisons with countries competing with Senegal, how did the staff assess the appropriateness of the wage policy? Moreover, while interest rates have recently been adjusted upward, could monetary policy have been used more actively to avoid overburdening other policy instruments?

The slow pace in widening the scope of the private sector is worrisome. At the same time, performance contracts for the public sector enterprises do not seem to be working well in strengthening those enterprises' finances. I urge the authorities to move quickly to rehabilitate or liquidate the public sector enterprises and urge them to take advantage of World Bank assistance in this area. It is important that the Government adhere strictly to its commitment of complete disengagement from all nonstrategic enterprises by 1990/1991.

The staff expects gross domestic savings to increase at an average annual rate of 17 percent during the next four years, which is central if the economy is to grow at an average rate of 4 percent during the same period. Given past trends, the staff's projections seem overoptimistic. In particular, I have difficulty in understanding the rationale for a more than 20 percent increase in private savings in 1988/1989, when per capita income fell, political conditions were unsettled, and that interest rates were raised only at the end of the period. Are we on firm ground in projecting self-sustained growth at the planned rates?

I agree with the staff on the need for reform in the industrial area, to reduce distortions and to increase profitability and competitiveness. However, I am disappointed by the staff's treatment of the pricing of energy, which is an important input. I fail to see how the domestic energy costs of the industrial sector will be reduced when petroleum products will be subjected to three layers of taxation, namely, an import tax, a value-added tax, and a petroleum levy. The staff adds that "the new system will be carefully monitored during a trial period to ensure that it is resulting in higher receipts." How are the costs to industrial users to be reduced? Petroleum products are like any other industrial input and should be treated as such. While I recognize the need for higher revenues, overtaxation of petroleum products can only result in the continued underdevelopment of the transport, agricultural, and industrial sectors and will consequently lead to slow growth and a narrow tax base. Obviously, there is a need for an optimal level of energy pricing and taxation. Has the staff considered the costs and benefits of this overtaxation for the economy as a whole? The staff could usefully comment on the rationale for the authorities' petroleum pricing policy, especially in terms of its effect on the development of the productive sectors.

Mr. Grosche stated that growth had almost halted completely in Senegal recently. However, further progress had been made in reducing inflation, and the balance of payments account had adjusted further, albeit at a slower pace than expected. The momentum of structural reform, moreover, had been more or less maintained.

The nonobservance of the financial targets were reason for serious concern, and he therefore fully endorsed the staff's view that the authorities should give high priority to broadening the revenue base and to improving tax administration, Mr. Grosche continued. He would be interested in the staff's response to Mr. de Groote's observation on the possible reasons behind the drop in the ratio of fiscal revenue to GDP. Although the revenue shortfalls seemed to be the result mainly of external and noneconomic factors, at least part of those shortfalls had been caused by slippages in the authorities' implementation of tax reform and administrative measures.

He welcomed the envisaged steps by the authorities to prevent further slippages, as indicated in the statement by the staff representative, Mr. Grosche remarked. The envisaged revenue measures for the first half of 1990/91 had been taken already, and the revenue targets through 1989 had been met. He hoped that the Fund's projections were not overoptimistic and that a recovery in fiscal revenues of about 12 percent during the fiscal year could indeed be achieved.

To strengthen the fiscal position, it was also important for the authorities to maintain tight control of government expenditure, Mr. Grosche pointed out. In particular, the wage bill still seemed to be excessive in relation to overall expenditure. He therefore welcomed the Government's attention, as noted in Mr. Mawakani's opening statement, to reducing the size of the civil service. Irrespective of whether external support could be organized to support those efforts, it was important for the authorities to proceed in the area as quickly as possible. The fragility of the Senegalese economy was especially evident in the balance of payments outlook, despite the large projected reduction in the remaining financing gap over the medium term. Although it could be expected that the short-term gap could be closed by debt relief from Paris Club participants and other official creditors, the medium-term scenarios illustrated the vulnerability of Senegal's economy to external developments. Further efforts were therefore needed to broaden the export base over the medium term.

Capital flows were of critical importance, as well, for a positive balance of payments. He was pleased that tight monetary conditions would help to reduce capital outflows and, in fact, eventually reverse them, as had been envisaged under the program. In that connection, he welcomed the maintenance of positive real interest rates, which contributed to restraining inflation and to further increases in domestic saving.

There was no doubt that serious challenges lay ahead for the authorities, but, taking into account the country's track record, he was confident that Senegal would pursue the appropriate financial and structural policies with determination and perseverance, Mr. Grosche added. He could support the proposed decision.

Mr. Shrestha made the following statement:

> I welcome the authorities' request for a second annual arrangement under the enhanced structural adjustment facility. It is encouraging to note that the authorities have effectively implemented wide-ranging structural and macroeconomic policies, contributing to growth-oriented adjustment in recent years. However, the economy suffered a setback in the second half of 1988/89, mainly because of factors beyond the authorities' control. My own authorities express their sympathy to the authorities for the damage caused to the agricultural sector from uneven distribution of rain and the locust infestation of crops. I am relieved to note that, despite some financial slippages in 1988/89, owing partly to the above factors, the authorities have shown commitment to bring the economy back on track through adopting a number of important policy measures. They merit support from the Fund in their endeavors.
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> I broadly agree with the staff's assessment of the Senegalese economy, and the measures envisaged for 1989/90-1991/92, as outlined in the policy framework paper. In particular, I agree that the momentum of fiscal adjustment needs to be regained. The revenue mobilization effort has to be given high priority, accompanied by a substantial strengthening of the tax administration. I am pleased to note that the tax revenue target for the first quarter of 1989/90 has been achieved. Tax measures that have the dual objective of rationalizing the tax system as well as reducing distortions in the industrial sector are particularly welcome. The objective of increasing government revenue has to be reinforced by a restrained expenditure policy. It is appropriate that, under the latter policy, the authorities will make an effort to reduce the share of the wage bill in total government outlays, in consultation with the World Bank. I welcome the authorities' continued efforts to privatize most of the public enterprises and to liquidate others by the end of the program period. This will undoubtedly alleviate the burden on the government budget.

There is a clear need to restrain growth in domestic liquidity to below that of nominal GDP in order to reduce excess demand pressure. While the recent measure to increase interest rates is an important step in this direction, the enhancement of the process of financial intermediation is still necessary. In this context, I note that a comprehensive program is being developed in collaboration with the BCEAO, the World Bank, and other multilateral and bilateral creditors and donors to reform the banking system. I hope that the authorities will give priority to implementing the program.

I note that fertilizer subsidies have been eliminated, and that the producer price of groundnuts has been reduced, and a number of measures have been initiated to increase domestic cereal production. However, I have some difficulty in following the rationale for reducing the groundnut producer price in the face of the buoyant world price for groundnut oil, which will result in a huge surplus in this sector in 1989/90. The staff could usefully comment on this question, particularly on whether the surplus will be at the cost of farmers. I endorse the proposed decision.

Mr. Noonan made the following statement:

The challenge posed by the Senegalese case is formidable, not only for the authorities, but also for the international financial institutions and for those in the international community who try to assist the authorities.

Senegal has not been well endowed with natural resources. Consequently, the scope for diversification of its economy is limited. At present, it is highly dependent on one product, the groundnut crop. That has been the position for decades and no significant shift in that position is expected over the next several years. The economy is thus particularly vulnerable to the fortunes of that one crop. Senegal, being in the Sahel region, is subject to an unreliable and deteriorating climate; droughts, and the associated damage to the agriculture sector, are an affliction that must be expected. Moreover, the potential of drought to damage the economy has been aggravated by soil degradation as a result of overgrazing and the destruction of trees. Given those disadvantages, need locusts be mentioned at all?

Against that background, the setback suffered in the first half of 1989 must be accepted as an implicit hazard attendant to the Senegalese adjustment program--at least to the extent that it was attributable to factors outside the authorities' control. If those hazards must be accepted, as indeed they must, it becomes all the more important both for the authorities and the

Fund to ensure that setbacks are not aggravated by avoidable action, or, perhaps, more crucially, by inaction under the adjustment program. As regards the program itself, a great deal depends on an entrepreneurial response to liberalized economic conditions, a response that may not always be autonomous if culture and tradition are not favorable to entrepreneurship. In that context, the disappointing private sector investment response so far is therefore a cause for concern.

To date, the authorities have been reasonably successful in their efforts to induce the economy to grow sustainably. This has been borne out by the results achieved. Apart from 1989, satisfactory growth rates have been attained; domestic costs have been kept under control, contributing to a low inflation rate; and domestic savings have increased, helping to narrow the investment resource gap. Most telling of all these indicators, the economy is poised for further growth, and has not been toppled into decline by the most recent setback.

Nevertheless, I fear that some of the process of adjustment has been subject to avoidable delays and loss of momentum. Given the authorities' lack of freedom for maneuver in relation to the exchange rate, it is crucial that the other adjustment instruments available be used vigorously. We therefore wish to support the staff on the urgent need to broaden the tax revenue base and improve collection; contain public expenditure and improve its structure; get on with the task of making the labor market more flexible and to restructure energy prices; provide the economy with sound, well-supervised, yet competitive, financial institutions, without delay; speed the pace of reform of public sector enterprises.

As regards the reform of public sector enterprises, the favored options appear to be privatization and/or liquidation of the organizations. I would like to suggest that allowing the private sector to undertake the same functions as some public enterprises--on a level "playing field" of course--is another option which, in appropriate cases, could quickly improve competition and efficiency.

In 1988/89, the ratio of external debt to GDP climbed to a peak of about 80 percent. I recognize that much of the increase in the debt ratio arises from debt on concessional terms. Nevertheless, Senegal's capacity to service an increase in debt depends on improved economic performance, which depends further on the momentum of the adjustment process. There is no guarantee that providence will be any kinder to Senegal in the future than it has been in the past. It is therefore likely that there will be unavoidable setbacks again in the future. Consequently, it is essential that no opportunity be missed by the authorities to maintain the momentum of the adjustment process. On the understanding that that is their intention, we support the proposed decision. As a final point, I would note that the staff papers on Senegal amounted to some 250 pages. A more succinct presentation would be both possible and desirable in the future.

Mr. Pétursson made the following statement:

The setback to the adjustment program in the second half of 1989 is certainly regrettable. Senegal is currently at a critical juncture in its adjustment process, and strong efforts are required to redirect the economy back on track. The objectives to be achieved under the second annual arrangement are ambitious indeed, calling for strong policies by the authorities and perseverance in their implementation. The authorities' commitment to the program and Senegal's fine track record will undoubtedly be important for securing the external support required.

There are, however, some aspects of the program that are cause for concern. First, the long-term growth prospects of the economy are fairly precarious, and the projected rate of growth of output and the pace of external adjustment would seem ambitious. The structural reforms designed to promote private sector activity are indeed welcome; but I would caution against expecting the economy to respond immediately to the envisaged changes. Although structural reforms have been implemented quite impressively, decisive stabilization policies seem crucial to achieving a rapid revival of growth.

The medium-term scenarios show that Senegal's current account prospects depend largely on a strong export sector. Senegal does have a better chance than many other developing countries to diversify its exports, as domestic savings are relatively substantial, and are expected to increase even further. A continued active interest rate policy is therefore clearly called for, to sustain the high level of savings and to prevent capital outflows. Initiatives to stimulate domestic and foreign investment seem, however, to be needed urgently.

At this juncture, it is critical that Senegal's competitive position be improved further given that the real effective exchange rate is still above its level prior to 1985, and that export volumes have fallen. As discrete adjustment of the exchange rate is not an option, the authorities must rely exclusively on prudent demand management policies.

Fiscal restraint will play an essential role in the adjustment process. Like other speakers, I regret the shortfall in the budgetary receipts in 1988/89, and I am concerned that some of those were due to slippages and delays by the authorities in implementing revenue-enhancing measures. However, it is encouraging that the authorities seem to be committed to redressing these shortcomings and that the revenue measures envisaged in the program for the first half of the year have already been taken. Moreover, I welcome the authorities' intention to continue to defer low priority expenditures and their efforts to restrain public sector wage costs. Although there are uncertainties associated with achieving the goals of these policies, the relatively slow progress in rehabilitating the public enterprise sector is most discouraging, and I would therefore urge the authorities to give this issue high priority.

Concerning the policies needed to restrain labor and energy costs in the production sector, the authorities' measures to reduce labor market rigidities and to restructure the civil service in cooperation with the World Bank are positive. However, I note their intention to freeze minimum wages for industrial workers. I would appreciate a staff comment on whether the wage freeze, together with the already adopted plan to reduce energy costs, will be sufficient to counterweigh the appreciation of the exchange rate and thereby strengthen the competitiveness of the industrial sector. If the answer is negative, what further measures would the staff recommend? I would also like to join Mr. Al-Jasser in questioning how the authorities intend to bring about the stated reduction in energy costs for the industrial sector.

It is welcome that the authorities have obtained positive indications from donors and creditors regarding the possibility of receiving the needed exceptional financing. Nonetheless, weak implementation of the program or adverse external developments could easily derail it again. Clearly, any deviation from the stated policies should not be allowed to emerge, because the program does not have any leeway for them. I can support the proposed decision.

Mr. Zhang said that he wished to join previous speakers in supporting the proposed decisions, and that he concurred with the staff's analysis and appraisal of the Senegalese economy.

The authorities were to be commended for their effective implementation of wide-ranging structural and macroeconomic policies since 1983, Mr. Zhang continued. As a result of those policies, the economy had been revitalized, inflationary pressures had been reduced, and the external position had been strengthened. With the return to normal weather conditions, real GDP growth had averaged 4.3 percent a year during 1985-88. Moreover, the momentum of structural reform had been maintained in 1989. However, the economy had suffered a setback in the second half of 1988/89, mainly as a result of natural disasters, including uneven rain distribution and locust infestation, and civil disturbances. It was indeed encouraging to note from Mr. Mawakani's opening statement that the authorities, undaunted by the setbacks suffered in 1988/89, had reaffirmed their strong determination to pursue reform and their medium-term strategy.

He agreed with the staff that the authorities should concentrate their efforts in the period ahead on the four areas outlined in the staff appraisal, Mr. Zhang added. He wished to emphasize a few of those points. In particular, fiscal adjustment was an important aspect of the program. He therefore welcomed the authorities' efforts to regain the momentum of that adjustment. Priority was to be given to revenue mobilization. In that regard, Fund and World Bank technical assistance would be essential in assisting the authorities to strengthen revenue collection services, notably the customs and tax administrations.

Senegal was at a critical juncture in its adjustment process, and the timely flow of external financial assistance was indeed indispensable for the successful implementation of the program, Mr. Zhang pointed out. The authorities had shown courage and determination in implementing their adjustment measures, and merited the financial assistance of the Fund and other international institutions.

Mr. Monyake made the following statement:

> Since 1983, Senegal has had an enviable track record in implementing successive Fund-supported adjustment programs. Its demonstrated commitment to the effective implementation of the current program supported by the enhanced structural adjustment facility was therefore not a surprise. Indeed, the staff report shows that all performance criteria and structural benchmarks stipulated for end-December 1988 and end-March 1989 were observed satisfactorily. The slippages in the fiscal and monetary policy areas during the second half of 1989 were attributable largely to the negative impact of unfavorable weather conditions, locust infestation, and social upheavals, over which the authorities had no control. Nonetheless, other than the sharp decline in real GDP growth, from an average annual rate of 4.3 percent during 1985/86-1987/88 to 0.6 percent in 1988/89, most of the other major indicators of economic performance moved in a favorable direction and were broadly in line with program objectives. It is against this background of excellent performance, and my chair's firm belief that the authorities will remain steadfast in implementing the reinforced adjustment policies detailed in the updated policy framework paper, that I join other Directors in supporting the proposed decision.
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> I am particularly impressed by the authorities' commendable efforts to reform the banking sector, with a view to achieving the improved performance that is vital to the efficiency of the financial system and to the resumption of sustained growth.

Considering the need to sustain public confidence in the banking system, the authorities should exercise sufficient caution in implementing the reform program to ensure an orderly rehabilitation of the ailing banks. In particular, it is essential that appropriate arrangements be put in place to protect depositors' monies, especially small savers. It is therefore a cause for concern to read in the staff paper and to hear from the staff representative that, in the event that private shareholders in two out of the three banks marked for rehabilitation, the BSK and MFIS, cannot provide the additional resources required to restore liquidity in those banks by end-November, their licenses will be withdrawn and they would be placed under receivership. In fact, the two banks have been suspended already. The staff or Mr. Mawakani could usefully elaborate on what the authorities intend to do to protect depositors of the banks, if the shareholders ultimately fail to provide the requisite funding. My fear is that the action against the banks, if not handled carefully, could precipitate panic and a loss of confidence in the banking system. I wonder if an acquisition or merger could not be considered as feasible policy options. Besides, the authorities should pay equal, if not greater, attention to ensuring management efficiency in the industry generally, apart from capital adequacy. Experience in many developing countries has shown that bad management is a major cause of many bank failures, even when such banks are adequately capitalized.

The rationale for a 22 percent reduction in the groundnut producer price is well explained in the staff paper. My concern, however, is the possible negative effect of this policy on the external sector in the long run, considering that the world price of groundnut oil products has recently increased considerably. In the likely event that neighboring countries pay higher producer prices, substantial export earnings from groundnuts could be lost to Senegal through smuggling across its borders. In this regard, I recognize the limitation on the authorities' ability to use exchange rate policy to advantage, as Senegal is a member of the West African Monetary Union. However, the groundnut oil mills in Senegal could be assisted to reduce costs and to improve their operational efficiency through other means than exchange rate action, to give room for extension of price incentives to farmers.

The medium-term prospects of the economy appear to be promising, but their achievement depends largely on the authorities' continued commitment to strong adjustment and the willingness of foreign creditor and donor countries to support those efforts by bridging the external financing gaps through debt rescheduling and providing of new funds, on concessional terms. I ask Mr. Mawakani to convey the best wishes of this chair to the Senegalese authorities.

Mr. Fayyad made the following statement:

It is unfortunate that, after several years of progress as a result of wide-ranging structural reforms and macroeconomic adjustment policies, the Senegalese economy suffered a setback in the second half of 1988/89, owing mainly to drought conditions and regrettable social unrest. Although the momentum of structural reform was maintained during the year, there were slippages on the financial side. It is therefore encouraging that the authorities have reaffirmed their commitment to pursuing their medium-term strategy and have sought to reinforce their structural and macroeconomic policies in the context of that strategy, with a view to achieving a sustainable rate of growth under conditions of domestic and external financial stability. The measures being implemented by the authorities under the 1989/90 program bode well for the attainment of those objectives.

We support Senegal's request for a second annual arrangement under the enhanced structural adjustment facility; and we are in broad agreement with the thrust of the staff's advice, particularly in relation to the areas in which the authorities' efforts ought to be concentrated.

Current expenditures are projected to grow in 1989/90 by about 2 percent, primarily owing to an increase of 2.8 percent in the wage bill. The Government intends to hold the wage bill at CFAF 130 billion in 1989/90 and to limit it to CFAF 125 billion in 1990/91 through 1991/1992. Although the staff indicates that measures to achieve the said reduction, and subsequently to hold the line on the wage bill, will be examined during the midterm review, it would be useful if the staff could give some indication as to the kind of measures that may be involved. How does the planned reduction in the size of the civil service, referred to in the staff's opening statement, fit with the authorities' intentions? Is there a preliminary assessment available that includes the fiscal effects of the use of separation benefits referred to by Mr. Warner and Mr. Enoch? Let me add that the increase granted in 1988/89 would only offset partially the sharp deterioration in real wages experienced over the past several years. Holding the line on wages is, in the best of circumstances, a difficult measure to sustain, and must be particularly difficult against this background of a prolonged decline in real wages.

Real interest rates in Senegal are currently substantially positive, and interest rates were indeed raised in 1989/90, reflecting the evolution of interest rates abroad. The authorities are increasingly relying on interest rate policy in the conduct of their credit policy. While it is of course difficult to do much about the former source of upward pressure on interest rates, a strong and determined fiscal effort should help keep reliance on interest rates within reasonable limits. Of course, excessive reliance on interest rate policy is not without cost, and it would be interesting to hear from the staff what assumptions it has made regarding the evolution of interest rates in Senegal. Do the investment projections in Table 4 of the staff paper depend on those assumptions, or is the projected investment path assumed to depend mainly on institutional factors?

As the industrial sector is expected to be an important contributor to economic activity in Senegal over the medium term, the envisaged reforms in industrial policy--particularly those aimed at reducing factor costs--are key elements in the authorities' reform strategy. In this regard, the labor market reform to be supported by SAL IV, and the adoption of a plan of action to reduce the domestic energy costs of the industrial sector, are both welcome steps. As I understand it, the said plan of action involves a two-stage process in which the transfer is transformed into a tax in the first stage--thereby creating a permanent source of government revenues--and price adjustments take place in the second stage.

Mr. Fernando said that he would join other Directors in commending the authorities for their record of commitment to adjustment and economic reform. In view of the reasonable balance in the existing macroeconomic conditions, he recognized that the authorities' particularly difficult or painful policy choices had already been taken. Nevertheless, he noted their continued resolve and courage in taking the further actions necessary in the groundnut sector. He also emphasized the need for strong actions and continuing close review of fiscal differences and monetary policy, given the absence of the exchange rate as an economic tool.

Mr. de Groote had remarked about the emergence of public sector cross-debts alongside Fund-supported adjustment programs, Mr. Fernando continued. Another feature that struck him was the increase in nonperforming debts, especially in state sector banks. Of course, there were many reasons for those debts, but an important reason probably had to lie in the inevitable tightening of monetary policy as an important element of the authorities' stabilization effort. That situation would seem to provide a basis for structural adjustment in the financial sector, involving a focus on bank supervision in general, and reform and privatization in particular. Nonperforming portfolios had the effect as well of causing lending interest rates to be more positive than would otherwise be the case. That effect had implications for the supply side of the economy through reduced private investment. That train of events would require that adjustment in Senegal be financed for a long period by external funds.

He noted the many compliments paid by Directors to Senegal for maintaining a low rate of inflation and for the authorities' ability to reduce further that rate, Mr. Fernando added. However, he also noticed that price controls were widespread. For instance, while the staff had pointed out in its paper the recent deregulation of a number of items subject to price controls, some important items remained on the control list. First, in that regard, how confident could Directors be with respect to the accuracy of the price statistics' reflection of the underlying trend in prices? Second, did the prevalence of price control provide incentives for smuggling, and was there a parallel market for those items under price controls? Those possibilities had implications for tax revenues and for the external trade account, and perhaps for capital outflows as well. It was noteworthy in that context that the increase in private savings had not been matched by increased investment, either by the Government or the private sector.

Picking up on a point made by Mr. Enoch concerning civil service reform, he wished to know whether meaningful budgetary savings were possible in the medium term, for instance, over three years, Mr. Fernando inquired. A tight wage policy might not be sustainable over the medium term, or at least one that would freeze or reduce the wage bill. There were factors working to increase the wage bill; indeed, the civil service reform envisaged a leaner as well as a better paid administration. He recalled instances in other cases before the Board in which civil service reform had been undertaken in the context of substantial increases in compensation--with the support of the World Bank. Given all of those factors, where did the Fund stand? He agreed with the staff's appraisal and supported the proposed decision.

Mr. Kwon made the following statement:

> My chair broadly agrees with the staff appraisal, and has no difficulty in supporting the proposed decisions. After having achieved impressive progress in correcting macroeconomic and structural imbalances, the Senegalese economy has been experiencing a setback, beginning in the second half of 1988/89. However, this setback was due mainly to factors such as uneven rain distribution, a locust infestation, and civil disturbances, which were clearly beyond the authorities' control.
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> Despite virtually stagnant growth in real GDP in 1988/89, compared with a program target of 4.2 percent, the rate of inflation dropped below the program target, while the external current account deficit--excluding official grants--was reduced broadly in line with program objectives. Those developments--absent real growth performance--can be seen as a positive result of the authorities' vigorous adjustment efforts in recent years.
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> Since the factors affecting the economy in the second half of 1988/89 can be seen as mostly temporary--as we certainly hope they are--and as the authorities appear to remain committed to

adhering to the ongoing medium-term program, we believe that the temporary setback is reversible. Indeed, the staff representative's opening statement seems to confirm this view.

However, the challenges lying ahead are not easy ones and require more resolute action by the authorities. While we note a significant improvement in the mobilization of private savings in recent years, we would nevertheless emphasize the importance of the authorities maintaining appropriate fiscal and monetary policies to further increase domestic savings, which are necessary for the authorities to reduce Senegal's resource gap, as envisaged under the medium-term program. In this connection, I fully share the staff's view that the authorities will need to concentrate their efforts in the period ahead, in strengthening the fiscal sector, reducing distortions in the industrial sector, and accelerating reforms in the banking system and public enterprises. It is a welcome development in this respect that the authorities have successfully concluded their negotiations with the World Bank in formulating reform programs for the restructuring of the civil service and banking system, in the context of SAL IV and a financial sector adjustment loan.

It is unfortunate that Senegal is suffering a setback, owing to factors beyond the authorities' control, and I hope that the setback is temporary. I encourage the authorities not to lose the gains that they have achieved through a long and painful process of adjustment. At the same time, I stress the importance of an adequate level of financing, including debt rescheduling, for the ongoing success of the program.

Mr. Ichikawa made the following statement:

A year ago, Senegal initiated a comprehensive adjustment program under an enhanced structural adjustment arrangement. While performance during the first half of 1988/89 was commendable, adverse developments in the agricultural sector and unstable social conditions led to the nonobservance of a number of important benchmarks for end-June 1989.

Directors may recall that during the Board discussion on Senegal in 1988 (EBM/88/169 and EBM/88/170, 11/21/88), this chair raised some concerns about a number of the authorities' intended policies under the first annual arrangement. I broadly agree with the staff's analysis, but, at the same time, am also of the view that some of my chair's previous concerns remain valid.

This chair raised doubts at the past discussion on Senegal about the projected strong growth in fiscal revenue, given that the tax structure was highly dependent on import duties. During

1988/89, the slowing of imports, coupled with the significant delay in implementing tax reform measures, has resulted in a large decline in revenues and a widening of the fiscal deficit. On the expenditure side, while the increase in interest payments contributed to a slippage from the expenditure target, the authorities' lack of response in curtailing current expenditures is somewhat disappointing in view of the revenue shortfall. While I appreciate the authorities' determined efforts to reduce subsidies and price controls in the face of a difficult political situation, there seems to be much further room for slimming expenditure, and hence for reducing the fiscal deficit.

I welcome the authorities' determination to strengthen the fiscal structure, which should be a key element in the country's adjustment. I am particularly encouraged by the strengthening of the tax structure and improvement in tax administration envisaged under the current budget. I also welcome the revision in energy taxation, in view of the need to strengthen revenue structure and to alleviate the macroeconomic effects of price distortions. Nonetheless, while I understand the political sensitivity of the matter, I am concerned about the budgeted increase in the wage bill, particularly at this critical stage of adjustment. In this connection, I would encourage the authorities to pursue a fundamental revision of the civil service.

Needless to say, fiscal reform has to be supported by structural reform of the public enterprise sector. The Board has repeatedly urged the authorities to accelerate public enterprise reform. Some progress has been achieved in this area, such as the welcome reduction in transfers and subsidies. The conclusion of a new protocol defining the financial relations between SONACO and the Government would contribute to settling the complex cross-debt problem between public enterprises and the Government. However, I am concerned about the recent delay in concluding the rehabilitation and privatization of the public enterprise sector. In tackling the inefficiency of the public sector, particularly in terms of its macroeconomic effects, the privatization of loss-making public enterprises is urgently needed. I would urge that the authorities accelerate the reforms with determination.

I commend the authorities for their efforts to maintain positive real interest rates, which have apparently contributed to an increase in the domestic savings rate. Even so, as this chair noted on a previous occasion, sizable private capital outflows or capital flight has re-emerged, partly because of the erosion of the tight credit stance. To prevent further capital flight and to maintain price stability, a tight credit stance should be re-established. An important objective of monetary policy is to promote the flow of savings into productive activities in the economy; to this end, rationalization of the banking system is imperative, as clearly recognized by the authorities. I welcome the authorities' reform plan, including the improvement of banks' financial structure and banking supervision, as well as the reform of the banking system.

I welcome the authorities' remarkable progress in liberalizing the economy and agree with the staff that the labor and energy areas should be addressed in particular. Liberalization of the labor market must especially be pursued, to improve the competitiveness of the economy. I welcome the authorities' initiatives in this direction.

With respect to the medium-term outlook, while the marked increase in official transfers is projected to improve the outlook in terms of the overall balance, the underlying trade balance is projected to weaken significantly compared with the original program. I have some doubts whether such an external development fits the original objectives of the enhanced structural adjustment facility. I would appreciate the staff comment in this area.

While at the previous review of the arrangement, Directors commended the marked improvement in the economy, the underlying fragility of the Senegalese economy has been evidenced in the second half of 1989 by several adverse developments. It is clear that the authorities have to step up their adjustment efforts, to keep the economy on the track of growth-oriented adjustment over the medium term. The economy's increased dependence on external assistance in that period is somewhat disappointing; but in view of the right orientation of the policy reforms and the authorities' achievement so far, I can endorse further Fund support under the enhanced structural adjustment facility. I support the proposed decision.

Mr. Kabbaj said that he wished to express his support for Senegal's request for the second annual arrangement under the enhanced structural adjustment facility. The authorities were indeed to be commended for their continued and courageous adjustment efforts thus far, taken to overcome the financial difficulties that had plagued the economy.

While the performance of the economy had been somewhat disappointing in 1988/89, owing mainly to natural calamities and other factors beyond the authorities' control, he was pleased with the structural reforms implemented so far, Mr. Kabbaj continued. Indeed, those reforms had enhanced the efficiency of the economy somewhat and had permitted the inflation rate to fall below the program target. Furthermore, the external position had improved, with the current account deficit, excluding grants, having reached the program objective, and the balance of payments, after debt relief, having attained a surplus, although a somewhat smaller one than previously targeted. Moreover, the authorities' adjustment efforts had enhanced the working of the private sector, improved the management of the private enterprises, strengthened the public investment programs, contained the growth of credit, reduced the overall fiscal deficit, and improved external debt management.

He concurred with the conclusions in Mr. Mawakani's opening statement and in the staff report, Mr. Kabbaj added. The comprehensive policy framework paper for the period 1989/90-1991/92 demonstrated the authorities' firm commitment to continuing and pursuing their adjustment efforts with a view to eliminating the economic and financial distortions. At the same time, he was pleased to note that a social program would be started to assist the poorest segments of the population. Needless to say, Senegal required continued international financial support if its adjustment reforms were to be implemented successfully.

To further reduce the fiscal deficit, he shared the staff's view that additional reforms were needed on both the tax and expenditure sides of the fiscal budget over the medium term, Mr. Kabbaj remarked. He welcomed the measures implemented already to improve tax administration and to contain expenditures. The work done to strengthen the authorities' public investment programming in cooperation with the World Bank was an important step in the right direction, which could lead to better resource allocation.

In the financial sector, the authorities' challenge was to reverse the capital outflows that Senegal had experienced, Mr. Kabbaj pointed out. Further reforms to stimulate domestic savings and to reorganize the banking system were therefore vital. In addition, strengthening bank supervision in order to enhance the availability of credit to the efficient sector of the economy was also crucial. And while the authorities were to be commended for their achievements in the public enterprise sector, it was obvious that more initiatives were necessary in that area. He was of course sympathetic with the authorities for their prudent stance in that sensitive area. Taking into consideration their previous record in implementing reforms, he had every confidence in the authorities' commitment to carry out further reform of the public enterprises, with the intent of divesting entirely from nonstrategic enterprises.

A social program would be started to mitigate the adverse effects of the structural reforms on the poorest segments of the population, Mr. Kabbaj commented. In that context, he was pleased to note that two programs, one with both the United Nations Development Program and World Bank, and the other with UNICEF, were already planned. He could support the proposed decision.

Miss Montiel stated that the performance of the Senegalese economy during 1988/89 had been adversely affected by exogenous factors, namely, a locust infestation of crops, bad weather conditions, and civil disturbances. Those developments had had a negative impact on agricultural production and on revenue collection, while also lessening confidence in the private sector and thereby leading to capital outflows. However, the authorities had pursued the program, and achieve substantial progress on the structural front through implementing the measures aimed at enhancing the efficiency and promoting the diversification of the agricultural and industrial sectors.

As she broadly agreed with the staff appraisal and the policy recommendations contained in the staff report, she would limit her comments to the fiscal sector, Miss Montiel continued. She could concur with the staff's view on the urgency of regaining the momentum of fiscal adjustment and its emphasis on revenue mobilization, but she had some doubts about the efficiency of import duties as a fiscal instrument, especially considering that the overall medium-term strategy continued to focus on promoting private sector activity through measures designed to reduce distortions and to enhance competitiveness, particularly in the industrial sector. The staff could usefully comment on that issue. She also had doubts about the optimism of the tax revenue target, which implied an increase in such revenues of 18 percent from their level in 1988/89. Tax revenues should be estimated conservatively, as they were a performance criterion. The staff expected that about 75 percent of the impact of the revenue measures would come from taxes on foreign trade, of which 14 percent would correspond with the increase in the customs duty rate. The revenue increases would depend not only on the consolidation of fiscal administration but also on the level of imports, which were beyond the authorities' direct control.

The slippages in privatization were, in fact, a common characteristic of adjustment programs in developing countries, Miss Montiel pointed out. It seemed that the legal, economic, and financial problems inherent to success in the complicated process of privatization had consistently been underestimated. For that reason, it would be useful if the staff revised its methodology for setting privatization performance criteria in developing countries. She commended the authorities for their perseverance in their adjustment effort, and supported the proposed decision.

Mr. Hogeweg said that he agreed with the staff appraisal and that he could support the proposed decisions. It had struck him, nonetheless, that the adverse developments in the second half of 1988/89, such as the locust infestation, drought, and civil unrest, seemed to have been treated by the staff as entirely exogenous and beyond the authorities' control. In a sense, those developments were indeed exogenous; but along the lines of Mr. Noonan's statement, he wondered whether the impact, on agricultural output for instance, of the drought and locust infestation might not have been exacerbated by earlier agricultural policies. Also, the staff report had been relatively brief in regard to the nature and extent of the civil disturbances, and he wondered whether there had been any connection between that unrest and the authorities' adjustment effort. Moreover, how well could the long-term impact of those disturbances be assessed, and how likely were the assumptions underlying the medium-term scenarios?

The staff representative from the African Department said that developments in 1988/89 had underscored the vulnerability of the Senegalese economy to weather conditions. For the first half of 1988/89, the program had been implemented successfully, but a locust infestation and uneven distribution of rain in the second half of that year had led to a 14 percent decline in real value added in the agricultural sector, and had severely affected other sectors. There had also been social disturbances related to a border conflict with a neighboring country; those disturbances had abated. The momentum of adjustment from previous years had carried through into 1988/89. Nonetheless, the inflation rate had been lower than projected, and the external current account, excluding official transfers, had been broadly in line with program projections.

The authorities were deeply concerned about the economic and financial situation and had reiterated their strong commitment to continue the adjustment effort, the staff representative stated. They had indicated that they wished to strengthen the program with a view to maintaining the momentum of adjustment, resuming growth, and continuing the reduction in the fiscal imbalance. The vulnerability of the structure of the economy was a deep concern to the authorities, and they had been paying increased attention, therefore, in the context of the public investment program, to irrigation projects, with the intention of moderating the effects of fluctuating weather on the agricultural sector. The process involved would be a long-term one. The authorities had been emphasizing the diversification of the economy away from the agricultural sector and toward the industrial and tourist sectors, through economic liberalization and improvement of the regulatory environment, particularly in the labor and energy markets.

The elasticity of the tax system in Senegal was indeed low, owing in part to the growth of the informal sector, the staff representative continued. The liberalization of the economy had made the tax system even more complex than before, and had made it more difficult for the tax administration to collect taxes effectively. Even so, the revenue shortfall in 1988/89 had been the result mainly of the drop in economic activity in Dakar, and only to a limited degree from certain slippages in the implementation of envisaged measures. The authorities were considering putting in place a wide range of tax measures, including expanding the coverage of the higher rate of the value-added tax; extending the value-added tax to trade and other services with a view to taxing the informal sector; increasing the customs duty rate; introducing minimum tax assessments for imports; and reinforcing customs administration, particularly through computerizing the customs procedures and expanding the withholding tax scheme. A major reform for improving the elasticity of the tax system would be the conversion of the existing schedular income tax to a global income tax. In that regard, he would note that the exemptions on payroll and contributions of income tax by employers under the new, liberalized labor regime were not expected to have a significant impact on revenue, insofar as they applied only to new employees and factories. In any event, the targeted increase in revenue for 1989/90, net of the effects of the exceptional events of 1988/89, was not substantial; in fact, it would amount to an annual average of growth rate of only about 6 percent relative to 1987/88. The authorities, moreover, had emphasized the importance of close monitoring of fiscal revenues, and had set monthly targets for revenues, reporting the results to the Fund every month. In the event that a revenue target for any two month period was not achieved, the program had a trigger clause that would prompt consultations with Fund management.

Senegal's customs tariff structure was one of the simplest ones in Africa, the staff representative pointed out. There was a distinction between the customs and fiscal duties in the external sector based on the difference between the purposes of protection and the meeting of fiscal objectives. The value-added tax was distinct from those duties, as it was a tax on consumption. The computerization of customs procedures would help in the management of all three tax instruments.

The envisaged new system for taxation of the energy sector would aim at transforming the fiscal revenues from the petroleum sector, from a residual transfer of oil surplus receipts to more durable revenue receipts per se, the staff representative commented. The objective was to reduce the vulnerability to the Government to fluctuations in revenue from oil refineries and to increase the efficiency of the latter by giving them a fixed handling fee for their operations. The price reform of petroleum products would depend much on the results obtained in the monitoring period under which the new tax system would be put in place. It was expected that the new tax system would result in increased revenue, which should eventually permit a reduction in the price of energy without jeopardizing the Government's revenue position.

With Fund technical assistance, the Government had been reviewing the special accounts in the Treasury, with a view to consolidating them into the budget, the staff representative added. A detailed report had been prepared, and the authorities were examining its recommendations. Furthermore, they had made considerable progress in the discussions with the World Bank in regard to the question of the government wage bill and the plan of action to reform the civil service. They had agreed with the Bank to reduce the size of the civil service by 10 percent over the next three years, through a system of voluntary departures. That system would cost about $75 million between 1990 and 1992, and the authorities were working closely with the World Bank to secure the financing required for the program. The immediate salary savings over three years from the voluntary departure system would amount to about $37 million.

The elements of the labor market reforms had been described in his opening statement, the staff representative remarked. To make the labor market more flexible and to reduce wage levels, with a view to enhancing the economy's competitiveness, new and expanding firms would be exempted from the general payroll tax--representing about 3 percent of the wage bill--as would be the case with the income tax contribution of employers, which would probably reduce the wage cost to employers of new employees by about 12 percent. The authorities were also committed to maintaining for three more years the freeze instituted in 1985 on the minimum industrial wage.

Price controls had been curtailed sharply, the staff representative continued, and, indeed, had been removed from all but 17 essential or strategic products in the past few years. The Government had indicated that it wished to reduce further the scope of price controls and that it would continue to review the controls on the remaining 17 products. He was not aware of any parallel markets for those 17 products.

Since 1985, six public enterprises had been privatized and nine had been liquidated, the staff representative pointed out. The authorities appreciated that the pace of those reforms had been slow and that a new strategy was needed, particularly concerning privatization. Ongoing discussions on the issue were being held with the World Bank in the context of SAL IV, and they had identified with the Bank staff 30 public enterprises to be privatized and 10 to be liquidated. The problem remained that of finding specific methods for privatizing those enterprises, which, if it was not possible, Senegal was committed to liquidating by 1991. It was expected that eight additional enterprises would be rehabilitated under the system of performance contracts by 1989/90. The contracts would be detailed ones, setting out certain objectives and clearly defining the relations between the Government and the enterprises.

The authorities intended to increase the efficiency of cereals production through promoting semi-industrial processing of local cereals, the staff representative added. They would also promote the domestic marketing of rice; in that connection, the domestic producer price of rice had remained unchanged even though the price of imported rice had been reduced. With respect to the groundnut sector, the authorities had reduced the price of groundnuts in order to strengthen the sector's financial position, thereby allowing the Government to reduce its subsidies to the sector, which had begun to weigh heavily on the fiscal budget in the past few years. Together with improvements in the efficiency of the operations of the groundnut oil processing plant, that price adjustment had strengthened the financial position of the groundnut sector and should result in a surplus in that sector in 1989/90, to be transferred to the budget.

The Central Bank of West African States (BCEAO) had pursued an active interest rate policy over the past year, with the objectives of stimulating savings, improving the allocation of scarce credit, enhancing financial intermediation, and preventing capital outflows, the staff representative indicated. In the past year, the BCEAO had relied more on indirect monetary policy instruments, and had, in fact, raised its discount rate in October 1989 to 10.5 percent, compared to the inflation rate of 2 percent. The Central Bank viewed the higher interest rate, inter alia, as a means of improving the efficiency of investment, reducing administrative controls on credit allocation, and as an important means of increasing the proportion of domestic savings would that finance local investment. Other factors influencing investment included the liberalization of the economy, the reduction of labor rigidities, and the reform of energy pricing. In connection with the BCEAO, the authorities were placing strong emphasis on strengthening bank supervision. Their interest rate policy would also likely help improve the position of banks, by reducing the existing administrative controls on the allocation of credit. They had suspended two banks, the BSK and the MFIS, because the private partners of those banks had not been able to present a viable restructuring plan. However, the authorities were in close contact with the private shareholders to see whether a viable plan could be put in place before end-December 1989.

The Government recognized that Senegal's exchange arrangements implied the need for a more intensive use of the fiscal policy instrument, the staff representative stated. It had indicated that the program design in Senegal had taken into account the existing exchange arrangements, and considered that the benefits of convertibility were such that the system of no exchange restrictions had reduced economic distortions; indeed, there were no parallel markets for foreign exchange in Senegal. In large part, the authorities believed that the disequilibria had been the result of fiscal imbalances, and they had therefore reduced the budget deficit, on a commitment basis and excluding grants, by over 50 percent between 1983/84 and 1987/88. They had also pointed out that their restrained monetary policy had reduced absorption over time, with the domestic resource gap as a result having narrowed from 12.2 percent of GDP to about 6 percent in the same period.

The Government was concerned about following appropriate policies for increasing the economy's competitiveness, the staff representative commented. The introduction of greater flexibility in the labor market and reduction of the wage level had been important policy objectives. The authorities, indeed, had underscored Senegal's restrained wage policy since 1983; and while the minimum industrial wage had been raised once, in 1985, it had fallen by 20 percent in real terms between 1983 and 1989. They were committed to maintaining this wage policy for a further three years. The reform of energy prices would also help to increase the productivity of the industrial sector. They had highlighted, furthermore, the extremely low inflation rate in Senegal, which had led to a decline of the real effective exchange rate of about 9 percent in the two years of 1987/88-1988/89.

Mr. Enoch inquired whether the voluntary retirement scheme for the civil service, which was expected to cost about double the expected savings in salaries in the next three years, was the most efficient means of implementing civil service retrenchment.

The staff representative from the African Department responded that, while it was indeed the case that the immediate savings in salaries would be only about one half the value of the retirement scheme's cost, the authorities hoped to avoid the considerable social problems that had arisen over the past three years from the already implemented reduction in civil service staffing, and also from the staffing reduction in the public enterprise sector. The retirement scheme, which had been designed with the help of the World Bank and which would provide the equivalent of three to four years of salaries to departing employees, should be looked at in a longer-term perspective than three years, or as the start of a major reform of the civil service, to reduce personnel by 6,000.

Mr. Al-Jasser noted that, in both the main staff paper and the policy framework paper, energy pricing had been discussed in the context of industrial policies. As it was important to have a balanced focus on the impact of such pricing on the fiscal accounts, particularly revenues, and on the cost of energy to industries, what had been the staff's reasoning in pointing out that the reform of energy pricing would increase the Government's revenues while noting at the same time that energy cost to industries would fall?

The staff representative from the African Department replied that the authorities had been trying to balance the twin objectives of increasing fiscal revenue from energy products--in view of their concern about a possible erosion of such revenue, accounting for about 13 percent of total fiscal receipts--and promoting conservation and efficiency in the use of those products in order to reduce costs to industrial users. To make oil refinery cost more transparent and to provide an incentive for increased efficiency in the refinery, a study by the Fund and the World Bank had examined how the tax system could be changed, in a manner that would allow a reduction in certain energy costs without eroding the fiscal revenue base.

Mr. Hogeweg inquired whether the civil unrest had had fiscal consequences, in terms of military expenditures or the need to care for refugees, and whether it had affected regional trade and cooperation.

The staff representative from the African Department remarked that the staff's analysis of the data and its discussions with the authorities indicated that the civil disturbances had had no major impact on fiscal spending, because the disturbances had been shortlived and because refugees had been cared for by family members. The more immediate impact of the unrest had been on economic activity, reflected in a temporary shortfall in fiscal revenue. The most recent data showed that revenue growth had resumed.

The Acting Chairman, in response to a Director's comment about the extent of the staff papers on Senegal, said that an effort had been made over the past year by the Director of the Exchange and Trade Relations Department and his staff to review the procedures through which the staff reported on discussions with authorities, with the intent of streamlining staff papers and avoiding duplication, and establishing greater continuity between Board discussions on particular country cases. In particular, an effort had been made to shorten papers on reviews of arrangements and to find ways to link them better to the papers on the requests for those arrangements, or to previous Article IV consultation papers.

In the current case of Senegal, the extensive staff papers before the Board partly reflected the inclusion of a background paper on recent economic developments, which, for the previous year's consultation, had consisted of tables only, the Acting Chairman added. Background papers provided good historical data and comparatively detailed discussions on countries' institutional structures; periodically, they would be longer than usual, to provide a more in-depth view of an economy's structure and to serve as a reference base for the next year's consultation, or even for consultations a few years ahead, depending on the institutional and economic changes within the countries under consideration. In that event, it might be a misnomer to refer to them as "background papers on recent economic developments." He hoped that it would eventually be possible to provide access to updated background papers, particularly their tables, via computer. Directors' comments on the merits of various means of presenting recent economic developments papers would be useful.

Mr. Mawakani indicated that he agreed with the staff representative's comments on Senegal and that he had only a few comments to make. He wished to assure Directors that the authorities recognized that they were at a critical juncture in their adjustment effort. The authorities were committed to the process of adjustment and were pursuing macroeconomic policies in line with the monetary policy of the BCEAO, consistent with a reduction in inflationary pressure and the provision of adequate financing to the private sector. The structural dimension of the Government's adjustment effort consisted largely of public enterprise reform, but the authorities were also making every effort to reform the labor and energy markets in order to reduce costs to the industrial sector.

The Acting Chairman made the following summing up:

Directors concurred with the thrust of the staff appraisal. They commended the Senegalese authorities for the effective implementation of wide-ranging structural and financial policies, which led to considerable progress toward growth-oriented adjustment during the period 1983/84 to 1987/88.

Directors noted that, following the further progress made in the first half of 1988/89, the Senegalese economy suffered a setback, owing in part to adverse weather conditions and civil disturbances, and to slippages in program implementation, particularly in the monetary and fiscal fields. On the structural front, Directors welcomed the reduction in the producer price of groundnuts; the elimination of most price controls; the rationalization of the system of effective protection; the initiation of banking sector reforms; and the implementation of a public investment program emphasizing the directly productive sectors. On the financial front, Directors expressed concern that the exogenous adverse factors, combined with a weakening in tax administration and delays in the implementation of certain revenue measures, had contributed to a shortfall in revenue, with the result that the budget target was not achieved. The fiscal slippage also led to higher growth of credit than programmed. Directors welcomed the active interest rate policy pursued by the monetary authorities, which contributed to an attenuation of private capital outflows over the period. In the circumstances, economic activity virtually stagnated, but inflationary pressures were reduced, and the external current account deficit narrowed. More generally, recent developments had demonstrated the fragility of the Senegalese economy's recovery. Growth prospects had improved somewhat, but private sector investment remained a source of concern. The productive and export bases were too narrow and vulnerable to external shocks. The achievement of medium-term viability in the balance of payments had been delayed.

Two general themes emerged from the discussion, with one Director noting in particular that providence was not likely to be kinder in the future than it had been in the past. The other related theme was the belief that the consequences of negative exogenous developments were likely to be less severe if Senegal could achieve its objectives of broadening and diversifying the economy. Thus, Directors welcomed the authorities' renewed determination to achieve the objectives of economic restructuring and adjustment. In this context, they noted that the overall strategy rightly continues to focus on improving the efficient use of public resources, as well as on the promotion of private sector activity.

The authorities were encouraged to regain the momentum of fiscal adjustment. Directors urged that the trend decline in fiscal revenue as a share of GDP be reversed resolutely. The revenue measures of the 1989/90 budget were welcomed, but concern was expressed about the continued reliance on trade taxes. The authorities should closely monitor revenue in order to adopt promptly any required additional revenue measures. Over the medium term, Directors supported the replacement of the current schedular income tax with a global system, and the expansion of the tax base to include the informal sector. They also stressed the importance of containing current expenditure and improving its structure, including, in particular, the reduction of the share of the wage bill. In that context, concern was expressed about the potential cost of the planned procedures for reducing the size of the civil service.

Directors underscored the need to strengthen financial intermediation, praised the authorities for launching a comprehensive reform of the banking system, and supported the policy of the BCEAO to maintain substantially positive real interest rates.

Directors indicated that the existing exchange arrangements could put a great deal of demand on other policies and on the need to maintain price stability and to contain costs. Thus, they emphasized the importance of enhancing the competitiveness of the industrial sector, and of broadening that sector. They observed that continued overregulation of private sector activity, particularly the labor and energy markets, constituted a serious hindrance to efficiency and growth. In this regard, Directors commended the recent introduction of greater flexibility in employment procedures and wage determination.

The authorities were urged to accelerate the reform of the public enterprise sector, and the Government's plans to make significant progress in the very near future in this area were welcomed. Directors expressed the hope that additional resources on highly concessional terms, in support of the country's economic development and adjustment efforts, would be forthcoming.

They emphasized the need for the World Bank to continue to assist Senegal, particularly through the fourth structural adjustment loan, which is expected to support critical structural reforms and to provide resources in support of the 1989/90 adjustment program.

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

The Executive Board then took the following decision:

1. The Government of Senegal has requested the second annual arrangement under the enhanced structural adjustment facility.

2. The Fund has appraised the progress of Senegal in implementing the economic policies and achieving the objectives under the program supported by the first annual arrangement, and notes the updated policy framework paper set forth in EBD/89/357.

3. The Fund approves the arrangement set forth in EBS/89/218, Supplement 1.

Decision No. 9313-(89/158), adopted
December 8, 1989

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/89/157 (12/1/89) and EBM/89/158 (12/6/89).

2. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS - MEMBERS' COMPENSATION

The Executive Board approves, with one objection, the recommendation to adjust the compensation of members of the Joint Committee on the Remuneration of Executive Directors and their Alternates as set forth in EBAP/89/276 (11/20/89) and Supplement 1 (12/5/89).

Adopted December 4, 1989

3. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/89/84 (11/28/89) concerning an extension of leave without pay for a staff member.

Adopted December 5, 1989

4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/89/285 (11/30/89), and EBAP/89/289 (12/4/89), by Advisors to Executive Directors as set forth in EBAP/89/287 (12/1/89), and EBAP/89/289 (12/4/89) and by an Assistant to Executive Director as set forth in EBAP/89/288 (12/1/89) is approved.

APPROVED: August 3, 1990

LEO VAN HOUTVEN
Secretary