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September 26, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Mauritania - Structural Adjustment Arrangement

Attached for the records of the Executive Directors is the text of the structural adjustment arrangement for Mauritania agreed at Executive Board Meeting 86/161, September 22, 1986.

Att: (1)

Mauritania: Three-year and First Annual Arrangements
Under the Structural Adjustment Facility

Attached hereto is a letter with an annexed Policy Framework Paper and an annexed Memorandum on Economic and Financial Policies dated June 26, 1986 from the Secretary of State in charge of the Budget of Mauritania, and the Governor of the Central Bank of Mauritania, requesting from the Fund a three-year structural adjustment arrangement and the first annual arrangement thereunder, and setting forth

(i) the objectives and policies of the program to be supported by the three-year arrangement,

and

(ii) the objectives and policies of the program to be supported by the first annual arrangement.

To support these objectives and policies, the International Monetary Fund grants the requested arrangements in accordance with the following provisions and subject to the Regulations for the administration of the Structural Adjustment Facility:

1. For a period of three years from September 22, 1986 Mauritania will have the right to obtain three successive loans from the Fund under the Structural Adjustment Facility in a total amount equivalent to SDR 15.933 million.

2. The first loan, in an amount equivalent to SDR 6.78 million, is available for disbursement at the request of Mauritania.

3. The second and third loans will be available upon approval by the Fund of the corresponding annual arrangements and will be disbursed at the request of Mauritania. The amount of the second loan will be equivalent to SDR 4.5765 million, and the amount of the third loan will be equivalent to SDR 4.5765 million.

4. Before approving the second annual arrangement, the Fund will appraise the progress of Mauritania in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, taking into account primarily:

(a) the indicators described in paragraphs 5 and 11 of the Memorandum of Economic and Financial Policies,

(b) imposition or intensification of restrictions on payments and transfers for current international transactions,

(c) introduction or modification of multiple currency practices,

(d) conclusion of bilateral payments agreements which are inconsistent with Article VIII,

(e) imposition or intensification of import restrictions for balance of payments reasons.

5. In accordance with paragraph 3 of the attached letter, Mauritania will provide the Fund with such information as the Fund requests in connection with the progress of Mauritania in implementing the policies and reaching the objectives supported by the first annual arrangement.

6. In accordance with paragraph 4 of the attached letter, Mauritania will consult with the Managing Director on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because he considers that consultation on the program is desirable. These consultations may include correspondence and visits of officials of the Fund to Mauritania or of representatives of Mauritania to the Fund.

Mauritania - Letter of Transmittal, Request for Three-Year Arrangement
under the SAF and the First Arrangement Thereunder

Nouakchott,
June 26, 1986

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
700 19th Street, N.W. Washington, D.C. 20431

Dear Mr. De Larosière:

1. The attached Policy Framework Paper has been prepared in collaboration with the staffs of the Fund and the World Bank. It describes the major economic problems and challenges facing Mauritania; the objectives of a three-year medium-term program, the priorities and the broad thrust of macroeconomic and structural adjustment policies and the likely external financing requirements together with the available sources of such financing.

The authorities of the Islamic Republic of Mauritania will remain in close contact with the staffs of the Fund and the World Bank on developments and progress in implementing these policies, and the Policy Framework Paper will be updated annually as the program is implemented.

2. The attached Memorandum of Economic and Financial Policies pursuant to the policy framework described above sets out the objectives and policies for which balance of payments assistance is needed that the authorities of the Islamic Republic of Mauritania intend to pursue for the period July 1, 1986 to June 30, 1989, and the objectives and policies for the first year of this period. In support of these objectives and policies, the Islamic Republic of Mauritania hereby requests a structural adjustment arrangement from the Fund for a period of three years in the amounts that will be available to it under the Fund's Structural Adjustment Facility, and requests the first annual arrangement thereunder.

3. Mauritania will provide the Fund with such information as the Fund requests in connection with its progress in implementing the policies and achieving the objectives of the program.

4. The Government believes that the policies set forth in the attached Memorandum are adequate to achieve the objectives of its program but will take any further measures that may become appropriate for this purpose. The Government will consult with the Managing Director on the adoption of any measures that may be appropriate, at the

initiative of the Government of Mauritania or whenever the Managing Director requests such consultation.

Sincerely yours

The Secretary of State
in charge of the Budget

The Governor of the Central Bank
of Mauritania

s/s

Thiam Samba

Dieng Boubou Farba

Annexes: (1) Policy Framework Paper
(2) Memorandum of Economic and Financial Policies

MAURITANIA

Policy Framework Paper, 1986-89

I. Economic Background

1. In the last fifteen years Mauritania's economic development has been uneven and has been marked by major financial imbalances. The most serious problem has been the persistent series of droughts, which has led to a rapid process of desertification; as a result, the country has become structurally dependent on food aid. At the same time, the iron ore mining sector, which was a main source of growth in the early 1970s, was affected by the crisis in the world steel market in the second part of the decade and, as a result, the mining industry's share in GDP declined sharply. During this period, the country implemented a large public investment program financed almost entirely with external borrowing; the program channeled resources toward low-yielding projects and led to a large external debt and debt service. Domestic demand was sustained by an excessive growth of public expenditures, contributing to large balance of payments deficits. Price distortions and a restraining regulatory framework discouraged the development of viable small-scale private activity in the secondary sector, while, at the same time, hampering agricultural development.

2. Faced with growing economic and financial imbalances, the Government pursued corrective financial policies during the 1979-81 period in the framework of a program supported by Fund resources; as a result, a return to balance of payments equilibrium was achieved, thanks also to better rain conditions and a rapid growth in the fisheries sector's exports. Investment policies continued, however, to be ambitious (with fixed investment exceeding 30 percent of GDP over the 1981-84 period), and measures to correct structural imbalances remained inadequate. With a resumption of expansionary budgetary and monetary policies in 1982-83 and a growing overvaluation of the exchange rate, the balance of payments deteriorated sharply. By 1983, the Government's consolidated fiscal deficit, excluding external grants, was equivalent to 25 percent of GDP, and the current account deficit of the balance of payments (excluding grants) to 39 percent. Although in 1984 the Government tightened fiscal and monetary policies and started the rehabilitation of public enterprises, the adjustment effort did not adequately address the major supply-side problems -- in particular, price and exchange rate distortions. Despite an improvement in the current account, in 1984 the overall balance of payments deficit rose, and external arrears increased markedly to reach about SDR 105 million by end 1984. As a result of these trends, coupled with a population growth rate of 2.7 percent per annum, per capita income remained no higher in real terms than a decade before.

3. Because of its natural disadvantages, its history and its geopolitical situation, Mauritania has benefitted from a high level of foreign assistance, which has not been always used productively and has allowed delays in the introduction of the inevitable structural reforms of the economy. As noted above, the need for adjustment was accentuated by weak overall economic policies which resulted in poor management of public enterprises, inappropriate sectoral strategies, and selection of projects with low and even negative rates of return.

4. Against this background, since early 1985, the Government has embarked on a comprehensive adjustment effort. This effort has been supported by two successive one-year stand-by arrangements from the Fund; the latest, for an amount equivalent to SDR 12 million (35.4 percent of quota), expires on April 26, 1987. The major adjustment measures implemented so far have been: (i) substantial devaluation of the *ouguiya* and adoption of a flexible exchange rate policy; (ii) increase in official prices for basic foodstuffs, utilities and petroleum products, and the gradual decontrol of other prices; (iii) improvement in tax administration, together with stronger controls over current outlays, scaling down of public investment expenditures, and improvement in decision-making; (iv) intensification of the reform of public enterprises; and (v) increase in interest rates and implementation of restrictive credit policies, in particular vis-a-vis the Government. All the measures envisaged under the 1985 stabilization program have been implemented; the targeted substantial reduction of both external and fiscal imbalances achieved; and all the performance criteria through end-December 1985 observed. Similarly, all the measures envisaged under the first phase of the 1986 stabilization program in the area of agricultural prices, public investment, public finance, and banking sector were adopted as scheduled.

5. The Government is aware of the challenges posed by the country's poor resource endowment and harsh natural environment. It is determined, however, to implement all necessary measures to take full advantage of the potentialities which exist and to develop human resources. A first set of medium-term policy reforms was designed as part of an Economic and Financial Recovery Program for the 1985-88 period, formulated with assistance from the World Bank. This Program includes appropriate macro-economic objectives, together with structural policy measures and a public investment program. The contents of the Recovery Program have been extensively explained to the population in order to justify the magnitude of the austerity measures that have to be implemented. Based on this Program, the Government is negotiating specific measures with the donor countries. The donors, as a group, have extensively supported this adjustment effort. In the context of the Consultative Group in November 1985, they have pledged to maintain their past high level of support. In particular, they have granted debt relief and exceptional assistance amounting to SDR 160 million in 1985, which allowed the elimination of payments arrears. Debt relief for 1986 is projected to amount to about SDR 105 million. Debt rescheduling was

negotiated in two Paris Club meetings (April 1985 and May 1986) and through bilateral agreements.

6. The World Bank, in addition to supporting public enterprise rehabilitation, is assisting in the reform of the agricultural sector and in developing small-scale enterprise. A structural adjustment credit of US\$35 million and a new technical assistance project are currently under preparation to support the Government's structural reform efforts.

II. The Medium-Term Economic Framework

7. The broad objectives of the Recovery Program are: (i) to maintain an annual rate of growth of real GDP higher than population growth and reduce the rate of inflation; (ii) to improve the productivity of public investment, promote the efficiency of public enterprises, and stimulate the development of fisheries, the rural sector and small enterprises; and (iii) to increase the public and private savings rate so as to reduce reliance on foreign resources for financing investments and to reduce the current account deficits and achieve significant progress toward viability of the balance of payments. To achieve these objectives, structural policy reforms will continue during the 1986-89 period; these reforms are described in Section III.

Economic prospects

8. The Government has discussed the macroeconomic scenario attached to the Recovery Program with the Fund and the Bank staffs. The projections for 1986-89 are considered reasonable. The implementation of the restructuring measures are expected to increase GDP by 4 percent p.a. over the program period a rate which seems quite realistic if allowance is made for recovery from the climate-induced record low agricultural production of 1983-84. However, it must be recognized that over a longer time, the GDP growth rate may not exceed 2.5-3 percent, due to limited availability of natural resources, slow progress in water management and slow reconstitution of the livestock herd decimated by the drought. The expected recovery in GDP growth will be based on better integration of fisheries activities; development of agriculture based on flood recession and irrigation; and the promotion of new activities such as copper mining. The rehabilitation of the public sector and the restructuring of the incentive system and the banking system should allow a relatively rapid expansion of the still poorly developed private sector.

9. Investment efficiency will be improved through better programming and selection of high-return projects, which will lead to a decline in the ratio of public investment to GDP from 32 percent over 1982-84 to an average of 20 percent over 1985-89. This will require a significant change in public sector management. The size of public investment will be calibrated so as to limit new borrowing and reduce gradually the amount of disbursed debt in proportion to GDP. Starting in 1986, particular attention will be given to development projects financed both through "food for work" programs and through the proceeds from the sales

of food aid. A public investment program for 1985-88 consistent with these objectives has been prepared in consultation with the Bank.

10. The effort to mobilize domestic savings will be reinforced, the purpose being to increase the proportion of public investment financed domestically to more than 15 percent in 1989. This objective should be attained by achieving in 1989 a significant surplus in Treasury operations and by raising the profit margins of public enterprises. The consolidated budget deficit, including grants, will be reduced from 4.9 percent of GDP in 1985 to equilibrium in 1988 and a small surplus will be achieved in 1989. Moreover, actions will be taken to promote private savings.

Social impact

11. These austerity measures will demand sacrifices from the Mauritanian population. Moreover, the reform of the public sector will have a negative impact on employment in that sector. Budgetary austerity and the increase in prices and in charges for public services will affect the low income groups of the urban population, whose essential needs are currently inadequately met.

12. The Government will have limited resources to alleviate the negative social consequences of the recovery program. Nevertheless, some measures are expected to provide countervailing effects. Higher employment should result from the greater participation of Mauritanian citizens in the sectors promoted by the recovery program. Food policy, with its combination of remunerative producer prices and better criteria for free distribution and food-for-work projects, should start a process of promoting production and income for rural families, thereby helping reduce the exodus to urban areas. Strengthened income tax collection should promote a more equitable sharing of social costs and will be accompanied by a more important budgetary effort regarding social expenditures for essential needs.

III. The Policy Reforms

Administrative reform

13. The Government, aware of the inadequacy of the administration to discharge the tasks required by the Recovery Program, has started an administrative reform with the multiple objectives of strengthening economic management, improving operating procedures and rationalizing civil service organization. The reforms will take several years to complete but, in close cooperation with the World Bank, priority measures will be implemented over the next four years. Emphasis will be put on improving budgetary and programming procedures in the area of public finance. This will require a restructuring of the Ministry of Economy and Finance, which will take effect in 1987. The reform will be expanded to other key ministries starting with Rural Development. Central governmental functions will be reviewed to strengthen the inter-ministerial coordinating process and the efficiency of legislative procedures. A coordinating unit will supervise the implementation of the reform.

14. A prerequisite for strengthening the efficiency of the administration is improving civil service management. The first steps will be to carry out an audit of the payroll and an analysis of the wage and benefits structure to be completed by the mid of 1987. Personnel and financial management will be computerized and coordinated in 1987, and the Ministry in charge of the civil service will be strengthened to provide it with human resources planning capabilities. Together with the reorganization of the main ministerial departments, public service regulations will be more clearly defined, promotion rules clarified, and training and career planning strengthened before 1988. Efforts will be undertaken to reallocate personnel to the most essential positions, while eliminating redundancies.

Public finance management

15. There is now room to increase tax revenues through improved tax collection and a reduction in the large number of present exemptions, while a comprehensive fiscal reform is completed. The Government has already taken steps to that end. Additional reforms under study will focus on: (i) the complete review of the system of customs and tax exemptions, including those under the Investment Code; (ii) the improvement of the income tax base; and (iii) reform of the tax on the fishing and mining sectors to enlarge revenue while preserving competitiveness. These reforms, which are expected to be implemented beginning in 1987, should increase the buoyancy of tax revenues in relation to economic activity. In the medium and long-term, however, revenue expansion will depend on the growth of the economy.

16. The Government will continue to pursue restrictive expenditure policies, especially as regards wages and salaries, defense outlays, and subsidies and transfers. This will permit allocating a larger share of expenditures to the material and maintenance budget. Road maintenance, health and primary and technical education will receive priority. The staffing of the civil service will be strictly controlled in the period 1986-1989, and additional recruitment will have to be offset through the containment of wages, so as to maintain the wage bill unchanged in real terms, in conformity with the objectives of the recovery program. Subsidies, transfers and military outlays will be frozen in nominal terms. These policies will be reinforced by the administrative reform.

17. The Government intends to reorganize the investment programming process. To that end, a consolidated operations account will be implemented starting in 1987 with the technical assistance of the IMF; it will include a comprehensive public investment budget, including all the sources of financing. The Government expects through a rigorous system of project selection, programming and monitoring, to achieve a substantial improvement in project productivity.

Public enterprise rehabilitation

18. The Government is committed to improving the efficiency of the public enterprise sector in order to maximize the benefits from the

substantial investments that have already taken place. A program of public enterprise rehabilitation was introduced at the end of 1983 with the assistance of the World Bank. The enterprises whose restructuring is the most advanced are the electricity and water company, the port of Nouakchott, the post and telecommunications authority, the iron ore mining company, and the rural development agency. The Government will extend the scope of the rehabilitation program to other enterprises, starting in 1986 with those in the energy sector. Energy pricing and marketing will receive particular attention. At the same time, the Government has decided not to increase the number of public enterprises, to dissolve non-viable ones, and to privatize certain others. The Government has also put into effect a procedure for the settlement of reciprocal claims and debts between the State and the enterprises on the one hand, and between enterprises on the other. It will monitor the settlement of these debts. This first phase of the public sector rehabilitation program will be completed by the end of 1989.

The banking sector reform and credit policy

19. An essential task for the rehabilitation of the Mauritanian economy is the reform of the banking system whose efficient functioning is hampered by weak management, resulting in a large amount of non-performing loans representing about 60 percent of total bank assets. An important aspect of the new policy in this field will be the reduction of the Government equity participation in banks whenever required to establish independent and viable commercial banks with local or foreign private participation. At an initial stage, the participation of certain international institutions could be necessary. To achieve these objectives, preliminary actions have already been taken or will be adopted before the end of 1986 in close cooperation with the Fund, the Bank and the Arab Monetary Fund.

20. The Government is currently implementing measures to: (i) accelerate the recovery of frozen credits; (ii) stop the increase of banks' operating costs and strengthen profit margins; (iii) improve Central Bank control over commercial bank policies and strengthen its own organization and procedures; (iv) transfer the Central Bank's participations to the State; and (v) assess realistically the commercial banks' net worth and losses in order to prepare viable individual restructuring plans.

21. Agreements on restructuring plans for each bank -- through the increase of the participation of foreign and private shareholders -- are expected to be concluded in 1987. Returning the banks to a viable position and increasing the foreign participation in their capital will require a significant improvement of their balance sheets. To that end, it will be necessary that the Government assesses the State's financial obligations as shareholder, as owner of indebted companies, and as guarantor of non-performing credits. Its financial obligations could be covered by the cancellation of outstanding refinancing of banks by the Central Bank and by the proceeds of foreign aid, such as part of the adjustment credit currently being negotiated with the World Bank.

22. Concomitantly with the above financial and legal actions, the Government will proceed to reform the legal and administrative rules governing the banking system. It is expected that an agreement on the principle of the reform will be reached before March 1987, and its implementation will take place before the end of 1987.

23. Monetary and credit policy will be directed at containing the rate of inflation and maintaining aggregate demand in line with available resources and promoting private savings. In the allocation of credit, priority will be given to the sectors which are to be promoted under the Recovery Program. Credit accorded to the Government will not increase in view of the targeted improvement in its financial position. Interest rates are at present positive in real terms and their level and structure will continue to be adjusted so as to promote savings and ensure an efficient distribution of financial resources. Measures will be taken to stimulate workers' remittances from abroad.

Promotion of domestic production

24. One of the principal objectives of the structural adjustment strategy is to provide appropriate incentives for, and remove impediments to, the development of priority sectors, such as agriculture and fisheries. To stimulate agricultural production and processing and reduce the present dependence on food aid and imports, official producer and consumer prices have been increased significantly since 1985. A larger role is being given to the private sector in supplying the necessary inputs to the agricultural sector and to increase its role in all forms of production, servicing and maintenance activities. The policies that are being pursued to this end include the rationalization and strengthening of public services in which the Government has an irreplaceable role, the increased participation of farmers and herders in water and pasture management, and the encouragement of private sector involvement in food processing, distribution and marketing through changes in the incentive system. Following the reform of the banking system, a decentralization of farm credit system will be started.

25. A major instrument for promoting domestic production will be the increased allocation of food aid to finance projects that foster production, while containing the free distribution of food; this will require a strengthening of the administrative and programming capability of the Government food security agency (C.S.A.) and the full use of the Common Fund created in 1986. This Fund will coordinate the use of the proceeds from the food aid sales in agreement with the main donors. By October 1986, the Government will establish a coherent framework to set and review official agricultural prices with a view to encouraging agricultural production, and to avoid recourse to subsidies. The role of public agencies in food distribution will be subject to a comprehensive review. Over the long term, the promotion of food production requires careful planning of irrigation development; a first step in that direction will be the preparation of a master plan on the use of water provided by the new dams on the Senegal River. This master plan will be discussed in a special sectoral group meeting of donors to be convened before July 1987.

26. The Government intends to increase the contribution of the fisheries sector to the national economy. To this end, it will reform the incentive system, so as to attract more Mauritanian private sector participation, and it will take actions directed at strengthening port and other on-shore services, modernizing the fleet, diversifying foreign partners and markets, and developing complementary services (research, surveillance, training, banking services). An action program to mobilize foreign involvement will be presented at a sectoral group donor meeting in early 1987.

27. In the industrial and handicrafts sector, steps are being taken with World Bank assistance to improve the institutional organization with a view to promoting small- and medium-scale private enterprises, including credit facilities and technical assistance better suited to their needs. The liberalization of the price system, already underway, the revision of import controls and of the Investment Code (expected to be implemented in 1987), and the maintenance of an appropriate exchange rate will be important steps to encourage private initiative in this sector.

28. The iron ore mining sector, which has been a key source of economic expansion, has succeeded thus far to maintain its present contribution to the national economy through a successful improvement in the productivity and efficiency of the state mining company. However, the recent adverse trends in world prices will keep heavy pressure on the company to continue improving its performance.

Human resource development

29. The Mauritanian population has limited access to basic social services such as primary education and preventive health care. The trends in key social indicators such as literacy, infant mortality, and nutritional balance will have to be improved through a better-targeted use of public resources and greater population participation in social service delivery, in particular through food-for-work programs and the promotion of the private services. The main constraint remains the lack of budgetary funds. In the context of public finance rehabilitation, health services will increase their relative share of current expenditure in order to expand purchases of drugs and other products without which existing personnel and capital would be under-utilized. Concerning education, it is necessary to define precisely the allocation within the budgetary envelope, to focus on reducing costs, to promote training cycles that can be efficiently implemented in Mauritania, and to concentrate public assistance at the secondary and university levels on needy, deserving students. A significant reform of the education system will be implemented. Employment planning measures will be put in place to adjust training to the qualifications in need. More generally, efforts will be developed to control the rate of population growth and to program a better distribution of public infrastructure among regions, on the basis of their economic potential.

IV. External Policies and Financing Requirements

30. The Government attaches the highest priority to maintaining an appropriate exchange rate, which would ensure the competitiveness of the export sector and promote import substitution. This, together with an appropriate credit and public investment policy will allow the control of import growth. The current flexible exchange rate policy will be continued.

31. The implementation of structural policy reforms and the pursuit of the financial policies indicated above should lead to a sharp reduction in external current account deficits over the next four years: from 25 percent of GDP in 1985 to about 9 percent in 1989 excluding official transfers (or close to equilibrium inclusive of official transfers). These estimates are based on certain assumptions with respect to prices and international demand for the two main export commodities, iron ore and fish, but are surrounded by some uncertainties. If exogenous developments would be less favorable than projected, further adjustment measures may be needed. On the basis of these projections, the debt service ratio (30 percent of export revenues in 1985, before debt rescheduling) will gradually decline, and the need for exceptional financial assistance, including debt relief, will decrease from an estimated SDR 125 million in 1986 to about SDR 30 million in 1989. The closing of the financing gap and a desirable increase of foreign reserves (to the equivalent of three months of imports) will require -- in addition to disbursements under the Fund's Structural Adjustment Facility and the Bank's Structural Adjustment Credit -- further debt rescheduling. However, the rescheduling needed will gradually decline and new foreign borrowing will be serviced on schedule. For 1987, the financing gap will decline to about SDR 70 million which could be covered by possible disbursements under the Structural Adjustment Facility of the Fund, the Structural Adjustment Credit of the Bank, further debt rescheduling and possible exceptional assistance. These requirements are additional to approximately SDR 500 million already committed in external assistance (in the form of grants and loans) to finance the investment program in the 1986-89 period. The Government will seek an improvement in the composition of this assistance in favor of grants, in view of the high level of debt already contracted. As a result, total disbursed debt should decline gradually as a ratio to GDP from almost 200 percent in 1985. To improve external debt management, any new loans contracted or guaranteed by the Government, as well as any drawings against such loans, will require the authorization of an Inter-ministerial Committee, which will strictly monitor project appraisal and financing. The Government will not contract or guarantee loans at non-concessional terms of less than 15 years maturity.

V. Conclusion

32. The Government is determined to implement the necessary reforms which fall under its responsibility in order to control financial imbalances, improve the efficiency of the economy, promote savings, and thus lay the ground for future growth. External current and capital

market developments will be monitored closely to enable the authorities and the donor community to respond in an appropriate and timely manner to unexpected developments. Through its actions, the Government expects to convince the donor community to strengthen its assistance and target it to the various needs of the adjustment effort. Reactions to Government's policies from the donor community and international institutions had been favorable during the first Consultative Group meeting held in Paris in November 1985. The investment program which was presented at that meeting constitutes the basis for bilateral discussions with the donors to finance specific projects. Because of their priority in the economy, three sectors, fishing, drinkable water and irrigation, will be the object of sectoral meetings with donors during the first part of 1987. These three meetings are being prepared with the technical assistance from the Kuwaiti Fund, the Caisse Centrale de Coopération Economique, the UNDP and the World Bank. A second consultative Group meeting will be held in November 1987 to review the progress made after two years of the Recovery Program; at the same time a five-year development program for the 1988-92 period will be submitted for donors' support. The Government is improving the internal mechanisms of aid coordination, through a strengthening of the Financing Directorate of the Ministry of Economy and Finance.

MAURITANIA

Structural Adjustment Facility
Memorandum on Economic and Financial Policies
for the July 1986-June 1987 Period

1. The document setting forth the economic policy framework, which accompanies this memorandum, describes the objectives of the Economic and Financial Recovery Program for the period from mid-1986 to mid-1989 and the financial and structural steps envisaged to attain them.

The principal objectives sought are a rate of economic growth of about 4 percent on average, a reduction in the rate of inflation from 10.5 percent in 1985, to 6 percent in 1987 and 5 percent in 1988 and 1989, and a reduction in the current account deficit of the balance of payments, not including official transfers, from 25 percent of GDP in 1985 to about 9 percent of GDP in 1989, corresponding to approximate equilibrium when official transfers are taken into account. The improvement in the balance of payments on current account will entail substantial progress toward a viable balance of payments position and will make it possible to reduce recourse to exceptional assistance (including debt rescheduling) from about SDR 125 million in 1986 to about SDR 30 million in 1989.

2. To achieve these objectives, the authorities will pursue a firm policy of demand management through a reduction of the disequilibria in public finances and prudent credit and incomes policies, accompanied by intensification of the structural reforms already under way in the area of public investment, the public administration and the tax system, agriculture, and public enterprises, fisheries, small and medium-sized enterprises and the banking sector. These reforms include (a) a strengthening of administrative structures, enhanced effectiveness of current expenditure and expansion of the tax base by reducing exemptions and reforming direct taxation; (b) a more rigorous selection and monitoring of investments through the establishment of an investment budget, so as to increase the contribution of investment to growth while limiting the debt burden; (c) the establishment of an agricultural price structure which provides incentives to producers, together with a more important role for the private sector in marketing, processing, maintenance and service activities; (d) the reform of the fisheries sector to increase the extent to which it is integrated into the national economy; (e) rehabilitation of the main public enterprises; (f) reorganization of the banking system featuring an increased collection effort, restructuring and rationalization of the banks, and strengthening of management methods; and (g) reform of the Investment

Code and a liberalization of pricing and import regulations in order to encourage economic activity.

3. As regards fiscal policy, the recovery program seeks to achieve balance in the consolidated budget, including grants, by 1988 and to register a surplus in 1989. These targets are consistent with the improvement in the balance of payments; they imply an increase in the surplus of the Treasury, and an increase in the proportion of the investment program that is financed by grants. In line with the improvement in the Central Government's financial situation, bank credit to the Government will not be increased, so that the expansion of total credit may be devoted in its entirety to the productive sector. The expansion of credit to the economy will be kept in line with the real growth rate of GDP and the programmed rate of inflation.

4. The annual program for the July 1986-June 1987 period, which represents the first year of the three-year period for which an arrangement is requested within the framework of the Structural Adjustment Facility, incorporates the objectives and measures for 1986 described in the letter of February 4, 1986 from the Minister of Economy and Finance and the Governor of the Central Bank of Mauritania and in the memorandum on economic and financial policies attached to that letter, as updated by the letter of June 26, 1986 regarding the review of the stand-by arrangement.

The main objectives for 1987 are (i) to achieve a growth rate of GDP of about 4 percent, (ii) to reduce the rate of inflation to 6 percent, (iii) to reduce the current account deficit to about 6 percent of GDP and the overall balance of payments deficit to about SDR 70 million, and to achieve some increase in reserves. The financing need would be covered by further debt relief, possible disbursements under the Structural Adjustment Facility, the Structural Adjustment Credit of the Bank and some exceptional assistance.

In the first half of 1987, the Government plans to pursue a rigorous fiscal and credit policy and to make significant progress in the implementation of structural reforms. In view of the objective set forth in the Economic and Financial Recovery Program to reduce the consolidated budget deficit in 1987 by more than 1 percent of GDP, the Treasury's surplus should rise to about UM 1,800 million in the same year. This would be reflected by a Treasury surplus from July 1986 to June 1987 of about UM 1,700 million. On the revenue side, steps will be taken to reduce customs duty exemptions and an effort will be made to expand the base for direct taxes. The new Investment Code will enter into effect before mid-1987, but certain changes in exemptions will be introduced in the Finance Law for 1987. Tax reform in the fisheries and mining sectors will be implemented on the basis of recommendations in World Bank studies scheduled for completion by end-1986, and after consultation with the Fund. Changes will also be introduced for the tax on business profits. On the revenue side, the increase in personnel

expenditure will not exceed the projected rate of inflation and there will be no nominal increase in expenditure on subsidies and military spending. In order to enhance the efficiency of the administration, a civil service census will be completed in the early months of 1987 and the reorganization of career paths and the structures of ministries will be implemented with assistance from the World Bank.

5. As in 1986, credit to the Central Government will not increase during the first half of 1987. The rate of increase in credit to the private sector will be maintained within a limit of about 8 percent in accordance with the financing requirements for new investments; this corresponds to an increase in domestic credit of approximately UM 1,700 million between end-December 1985 and end-March 1987 and of about UM 2,000 million between end-December 1985 and end-June 1987.

During the period July 1986-June 1987 the Government will not contract or guarantee nonconcessional loans with less than 15-year maturities; no external payments arrears will be accumulated.

The targets through June 1987 as regards the Treasury surplus, the expansion of overall domestic credit and credit to the Central Government, nonconcessional borrowing and external payments arrears represent benchmarks for program monitoring.

6. As regards agricultural policy, a study of the entire grain sector, including the structure of production and marketing costs, will be completed by end-1986 and will serve as a basis for a readjustment of producer and consumer prices in March 1987. The role of the private sector in marketing and processing domestic agricultural output will be gradually expanded and the existing monopolies on the marketing of food products will be reviewed. Some rice mills will be privatized. In 1987, the present channels for distributing fertilizers and other inputs and supplies will be privatized in connection with the establishment of new credit facilities, thereby easing the role of SONADER. The reorganization of the Food Security Agency will continue in order to cut costs and improve its management. This should make it possible to free a greater proportion of the sales proceeds from food aid for use in project financing by the Common Fund for food aid counterparts.

7. An in-depth study on the fisheries sector and the steps necessary to promote its expansion and integration into the national economy is now under way; it will be completed by September 1986. On the basis of the results of the study, steps will be taken to promote expansion of the fishing fleet as well as to improve the supply of the on-shore processing facilities with a view to increasing value added.

8. In order to promote the development of the small industry and crafts sector, implementation of the reform of the incentive system under the Investment Code will start in the first half of 1987 on the basis of a study now in progress. The price liberalization policy begun in 1985 and 1986 will be continued. This will make it possible to prevent monopolistic situations and to encourage greater efficiency on

the part of domestic industry. The tariff protection system will be reviewed in the context of a study financed by the World Bank.

9. The steps to rehabilitate the public enterprises will be pursued vigorously with assistance from the World Bank. In addition to the actions under way for SONELEC (water and electricity), EMN (port), OPT (posts and telecommunications) and SMCPP (petroleum products distribution), technical and financial audits will be conducted by mid-1987 for STPN (urban transport), SOCOGIM (construction) and PHARMARIM (pharmaceutical products). The system for establishing energy product prices, which will be negotiated with the World Bank in July 1986, will be implemented in the course of 1986. This will be complemented by a price setting scheme for electricity based upon a study financed by the World Bank; a new price structure will be implemented in early 1987. The role of SMCPP in importing petroleum products will be reviewed and efforts to strengthen its financial structure will be continued.

10. The financial restructuring of the Mauritanian banks, with increased participation by foreign shareholders, will be finalized in 1987. In 1987, the authorities will implement the banking reform now under study and will prepare a revision of the accounting scheme and of the regulations regarding risks, capital and solvency. Particular effort will be made with regard to improving bank management procedures. This will be accompanied by a program of actions aimed at strengthening the Central Bank's ability to supervise the banking system. Major progress in this area will be accomplished by mid-1987.

11. The reduction of customs exemptions, the preparation of a new investment code, the reform of the system for establishing agricultural prices, the introduction of a new structure of electricity tariffs and petroleum prices, progress in the restructuring of SONELEC, SMCPP and of the banking sector will also constitute benchmarks for monitoring the implementation of the program.