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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/74-1

9:30 a.m., August 1, 2018

1. Gabon—Second Review of the Extended Arrangement Under the Extended Fund Facility, Requests for Waivers of Nonobservance of Performance Criteria and Waivers of Applicability, and Financing Assurances Review

Documents: EBS/18/72 and Correction 1; and Supplement 1

Staff: Segura Ubiergo, AFR; Sun, SPR

Length: 53 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	Alternate Executive Directors
	D. Mahlinza (AE)
	H. Razafindramanana (AF)
	C. Moreno (AG), Temporary
	G. Johnston (AP)
	P. Fachada (BR)
	P. Sun (CC)
C. Hurtado (CE)	
	L. Zorn (CO), Temporary
	C. Just (EC)
H. de Villeroché (FF)	
	K. Merk (GR)
S. Gokarn (IN)	
A. Leipold (IT)	
	M. Daïri (MD)
	P. Al-Riffai (MI), Temporary
A. De Lannoy (NE)	
	A. Jekabsone (NO), Temporary
	L. Palei (RU)
	S. Rouai (SA), Temporary
	C. Ong (ST), Temporary
M. Panek (SZ)	
	J. Stockill (UK), Temporary
	P. Pollard (US), Temporary

C. McDonald, Acting Secretary
S. Maxwell, Summing Up Officer
O. Bespalova, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: Dominique Desruelle, Anne-Marie Gulde, Azanaw Kassawmar Mengistu, Koffie Ben Nassar, Toomas Aarand Orav, David Robinson, Samuele Rosa, Alex Segura Ubiergo, Abdoul Aziz Wane. Communications Department: Ismaila Dieng. Finance Department: Maria Angelica Albino Orjuela. Institute for Capacity Development: Roger H. Nord. Legal Department: Wolfgang Patrick Bergthaler, Katharine Maria Christopherson Puh, Jonathan Mark Swanepoel. Research Department: Maria Soledad Martinez Peria.

Strategy, Policy, and Review Department: Narcissa Ioana Balta, Manasa Patnam, Yan Sun, misa takabe. World Bank Group: David Jacques Elmaleh.

1. GABON—SECOND REVIEW OF THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUESTS FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA AND WAIVERS OF APPLICABILITY, AND FINANCING ASSURANCES REVIEW

Mr. Sembene, Mr. Razafindramanana and Mr. Nguema-Affane submitted the following statement:

The Gabonese authorities are thankful to Management and staff for their continued support to their economic recovery program (PRE) supported by the Extended Fund Facility (EFF). Consistent with their commitment under the EFF arrangement, the authorities are taking a wide range of measures to advance reform implementation—albeit with delay at times—to keep the program on track. Faced with increasing resource constraints, the new government established in May 2018 an economic task force responsible for identifying a set of additional adjustment measures to firmly put public finances on a sustainable path, consistent with the objectives of the program. Such measures were adopted in the context of the revised 2018 budget, paving the way for their implementation. In addition, significant progress has been made in clearing arrears. In this light, the authorities request the completion of the second review under the EFF arrangement.

Recent Economic Developments and Program Performance

As noted by staff, macroeconomic conditions in Gabon have begun to improve gradually, notably with welcome signs of economic stabilization. Non-oil commodity sectors including mining, forestry, and agribusiness continued to experience fast growth, helping mitigate the effects of the slowdown in the overall non-oil sector. Inflation remains contained while the external position improved. An increase in oil and mineral exports helped to reduce the current account deficit in 2017. At the same time, an increase in foreign direct investments in the agri-business sector helped to improve the capital account. As a result, Gabon’s net foreign assets at the BEAC increased, thereby helping to further strengthen regional external stability.

Fiscal consolidation efforts continued in 2017. Although oil production declined, higher prices and exceptional revenues led to higher oil revenues. However, non-oil revenues fell due to weak economic activity and strikes in the tax administration. The introduction of new measures aimed at boosting non-oil revenue mobilization during the last quarter of 2017 helped to avert a more severe deterioration in revenues. Lower revenues and delays in the disbursements of external assistance - which materialized in late December 2017 - led to strong cashflow pressures which complicated budget execution. In the face of limited resource availability, additional cuts to public spending, notably capital expenditures, were made, thereby contributing to more than offsetting the decline in total revenues. As a result, the overall fiscal deficit on a cash basis was almost halved in 2017 to 3.4 percent of the GDP, which made it possible to contain external and domestic borrowing and ensure a reduction in total public debt. Budget execution since the start of 2018 remained difficult with renewed cashflow pressures stemming from a continued underperformance of total revenues.

Budgetary pressures and weaknesses in debt management undermined efforts to fully service some external loans and clear arrears in a timely manner, as envisaged at the time of the first review. As described in the staff report, further complications arose in early 2018, materializing into further debt arrear accumulation. Nevertheless, public debt remains sustainable following the significant progress toward rescheduling and clearance of debt arrears, particularly those owed to bilateral and multilateral creditors. The authorities are committed to making similar inroads with regard to arrears owed to commercial creditors. The stock of domestic debt also declined in 2017. In this connection, a new “Club de Libreville”, a payment plan used in the past to clear domestic arrears, has been agreed in April 2018 to settle a large share of domestic arrears to small- and medium-sized enterprises over the next six years.

The implementation of the wide array of fiscal reforms is advancing but at slower-than-expected pace, as indicated in the staff report. In particular, progress is being made in strengthening tax and customs administrations, improving public financial management, and enhancing public investment management. The strategy to reduce the wage bill resulted in modest savings in 2017 largely thanks to efforts undertaken to update payrolls and rationalize staff-related expenditure. In addition, the framework to secure timely VAT refunds is being put in place and several measures have been initiated to detect, prevent, and address cases of VAT fraud and led to tax adjustments.

Strong measures were taken to firmly put public finances on a sustainable path and to accelerate fiscal reforms. Given the persistent downward trend in total revenue, the authorities took in July 2018 a wide package of fiscal measures to further boost non-oil revenue and contain expenditures. These include reducing the annual wage bill by 10 percent in 2018 through wage cuts and freezes in recruitment, the elimination of one hundred autonomous agencies with their activities reintegrated into regular government ministries, and the streamlining of the costly program of customs duty exemptions. These measures were included in the revised 2018 budget, which has been approved by the Senate. It is the authorities' belief that they will contribute to further improving the fiscal position. As a contingency measure to better manage fiscal risks, an automatic adjustment mechanism has been set up to adjust public spending, except for social spending, in case non-oil revenue collection underperforms projections.

The banking system remains generally sound, but vulnerabilities are rising. NPLs increased and bank lending to the private sector declined further in 2017 and early 2018, reflecting notably stagnant economic activity and elevated domestic arrears. Progress in developing a framework for the resolution of NPLs has taken longer than expected due to financial constraints. Efforts by the authorities to resolve the three distressed public banks are advancing in collaboration with COBAC. A reputable international consultant will be hired this year to develop a resolution plan to minimize the related cost.

In terms of program performance, three out of five end-December 2017 performance criteria (PC) were met. Financing constraints were an important factor in missing the PC related to the non-oil primary balance and the continuous PC on external arrears and the three indicative targets on non-oil revenue mobilization, social spending, and domestic arrears. As indicated in the staff report, it is likely that these two PCs and the one on net central bank claims on the government were also missed at end-June 2018. Delays occurred in implementing structural benchmarks (SBs) through end-March 2018 but most related measures have been implemented since then.

Policies for the Medium-Term

Medium-term prospects remain relatively promising. The large and continuing FDI flows toward agri-business and other nontraditional sectors can help the Gabonese economy to reduce its dependence on oil and governmental activities. At the same time, higher oil prices, as well as recent oil discoveries and the ongoing work for a new fiscal regime for oil, should encourage new investments and contribute to economic activity in the service sector. The largely rural and labor-intensive agricultural and forestry projects could also generate positive spillovers, as reforms to improve the business climate are implemented. Credit expansion is expected to pick up as recovery takes place.

The authorities remain strongly committed to the program and intend to speed up reform momentum to strengthen macroeconomic stability and foster economic diversification while further contributing to the regional external stability. They agree with staff that there is a risk of social resistance to the recent policy decisions to contain public spending and that a disorderly implementation of reforms could threaten the achievement of the program objectives. To minimize those risks, they are strengthening coordination between government institutions.

Fiscal policy remains the centerpiece of the program. It aims at preserving fiscal and debt sustainability by targeting a reduction in the fiscal deficit in 2018 and a return to an overall fiscal balance and surpluses over the medium term. This progressive improvement of the fiscal position will make it possible to reduce the level of total public debt to below 50 percent of GDP by the end of the Fund-supported program and increase the fiscal space for higher social and investment spending. Given the tight financing constraints the country is still facing, further assistance from international organizations will be critical to financially support the authorities' macroeconomic and fiscal objectives, including to pay the domestic and external debt.

The authorities are committed to timely implementation of the critical fiscal reforms presented in the MEFP. In particular, ongoing efforts to increase domestic revenue mobilization will be sustained with a special focus will be placed on recovering tax arrears and strictly enforcing compliance with tax policy. To provide greater visibility to the creditors and address cash pressures, a new deferred payment that eliminate VAT credits will be introduced in the 2019 budget law. Fiscal reporting of earmarked revenues and corresponding expenditures, and the financial oversight of public entities and departmental agencies will be reinforced. The transparency of public procurement and the efficiency of public investment management will be improved. PFM reforms undertaken since 2015 will be consolidated. The Treasury Single Account will be consolidated through the transformation as TSA subaccounts of all existing government accounts in commercial banks. The predictability and quality of social spending will be improved, with the assistance of the World Bank.

The authorities will pursue the implementation of their arrears strategy and pursue the implementation of measures to prevent the accumulation of new domestic arrears. In particular, in addition to strengthening fiscal reporting, cashflow management is being reinforced, with regular meetings of the Government's Cashflow Committee, and monthly fiscal cash flow plan to ensure no short-term liquidity shortfall.

Preserving financial sector stability and ensuring that the financial sector play a leading role in supporting private sector activity remain a top priority in the national and regional authorities' agenda. Given that the rise of overdue loans to banks is a key financial sector vulnerability, the development of a framework for the resolution of NPLs will be a top priority.

The implementation of the structural reforms aimed at bolstering competitiveness and setting the basis for a strong and durable medium-term recovery will continue. Based on the first progress report of the PRE, structural reforms going forward will focus on restoring private sector confidence. These reforms include the completion of the land titling reforms by end-2018, the operationalization of the Arbitration Chamber that was created in April 2018; reducing time and costs pertaining to building permits; strengthening the one-stop-shop centers following their assessment study; and completing the ongoing reform of the labor code with the objective to make it more flexible and increase formal employment in the country.

Conclusion

Despite underperforming revenue collection, the authorities remain committed to the objectives of their Fund-supported program and have taken decisive actions to keep it on track. In light of these actions, Director's favorable consideration of the authorities' request for the completion of the second review of the program under the EFF arrangement will be appreciated. They also request a waiver of nonobservance for the continuous performance criterion on external arrears accumulation and two end-June performance criteria related to non-oil primary fiscal balance and net central bank claims on the government.

Mr. De Lannoy, Mr. Leipold, Mr. Manchev, and Mr. Persico submitted the following joint statement:

We thank staff for a comprehensive report and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their informative buff statement. Gabon continues to face the same challenges as its commodity-dependent CEMAC peers. The policy efforts since December have been weak and fallen short of the pace and scope of adjustments necessary to effectively address the twin deficits and ignite a dynamic economy. Addressing the tight liquidity situation and restoring the programmed path of fiscal adjustment requires deep structural reforms and a substantial improvement in the public finance management (PFM). We can go along with the proposed decisions, given the ambitious supplementary budget adopted on June 29, which targets an improvement in the non-oil primary balance of about 2½ percent of non-oil GDP in 2018. The revised budget reinforces the government's commitment to the Fund-supported program, but continuous outreach efforts and dialogue across the political spectrum and civil society will be critical for its implementation. We also note that the success of Gabon's program is key to support the regional economic strategy of the CEMAC region.

Accelerating structural fiscal reforms is key to program implementation. The recently approved supplementary budget introduces a robust fiscal consolidation package to avoid the accumulation of new arrears, rebuild fiscal buffers and ensure debt sustainability. The suggested consolidation revenue/expenditure policy mix rightly emphasizes mobilizing non-oil revenues and containing current spending, especially the oversized public wage bill. However, given the disappointing trend in non-oil revenues in recent years, we wonder if the envisaged measures are well sequenced and sufficient to reverse the dynamics in line with the program expectations. We note that the observed underperformance of non-oil revenues in 2017 was also explained by social tensions with the personnel in charge of the collection of tax and custom revenues. As the wage bill and bonuses reduction in "non-social" sectors are essential in the proposed public expenditure rationalization, could staff provide their prospects on this front going forward?

Strengthening the PFM is imperative to successfully tackle the arrears and implement the 2018 supplementary budget. Consistent failure to meet the PC on accumulation of new external arrears points to the critical need for a prompt implementation of the planned structural fiscal measures aimed at preventing accumulation of new arrears. The PFM reforms should be bolder and deeper to prevent arrears accumulation and implement decisive revenue and expenditure measures to accelerate clearing the existing arrears. In this regard, we welcome the introduction of the high-level regular monitoring on cash-flows, including from the President's office, as a measure to better address the problem with persistent domestic and external arrears. Stringent control and audit should be introduced over the public employees, given that some expenditure rationalization measures take more time to achieve the envisaged targets. We support the envisaged measures to safeguard social spending and quality of service delivery, especially through improving monitoring and reporting, and protection of salaries in the social sectors.

The most pressing issues related to the banking sector reform should be addressed without any further delay. We support the revised timetable for the banking sector reform under the program, and encourage the authorities to firmly observe the schedule. The authorities should step up their efforts to resolve the three distressed public banks while minimizing fiscal costs and safeguarding depositors. Given the weak public finance, they should refrain from any further bank recapitalization with public funds and consider privatization of the controlling stake in the third largest Gabonese bank. Any further government support to the SMEs should be extended through the commercial banks instead of through direct lending, which has failed to stimulate private sector growth. The rising trend in the NPLs requires steadfast progress in strengthening the legal and supervisory framework for their monitoring and resolution. In this regard, special attention is needed to increase the efficiency of the commercial courts and achieve a breakthrough in the overhaul of the real-estate credit registry.

Far reaching structural reforms are essential to foster private sector development as a primary engine for returning to sustainable growth. Gabon's external position is weaker than implied by fundamentals and desired policies. Given the constraints of fiscal consolidation and tight regional monetary policy by the community's central bank BEAC, the reforms should primarily aim to improve the business climate and remove bottlenecks to new investment in the sectors where Gabon has comparative advantage. Like staff, we encourage the authorities to operationalize the Extractive Industries Transparency Initiative (EITI) and fully implement the newly introduced framework for public-private partnership.

Finally, we note that lack of adequate statistical data remains a serious challenge for policy making, program design and monitoring. Addressing the remaining weaknesses should remain a top priority for both the authorities and technical assistance from the Fund. Could staff update us on the recent steps under the program to improve quality and dissemination of the statistical information?

Mr. Alogeel and Mr. Rouai submitted the following statement:

We thank staff for the well-focused report and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their informative buff statement. We take note of the mixed program performance, but commend the Gabonese authorities for the inclusion of corrective measures in the supplementary budget and the implementation of several delayed structural reforms. We broadly agree with staff's conclusions and policy recommendations and support the proposed decision.

We welcome the fiscal consolidation efforts in 2017, but note that most of the adjustment was achieved because of the decline in capital expenditure. In addition, fiscal revenues were affected by delays in the introduction of announced reforms and excessive use of tax exemptions, resulting in further accumulation of arrears. Against this background, we welcome the package of fiscal measures introduced this month to boost non-oil revenue and contain expenditures.

We welcome the elimination of the costly and ineffective program of custom duty exemptions. We note that staff characterizes this program as “illegal” since it relies on ad hoc ministerial orders rather than a tax law. While 85 percent of the list of products benefiting from exemptions were eliminated, few pro-poor items in the list are still exempted and we wonder why they have not been approved by law. Staff elaborations are welcome.

We are disappointed by the continuous slippages in the pro-poor spending. The floor on social protection spending was missed all along 2017 and no data are being provided on the level at end-March 2018 or end-June 2018 (MEFP, Table 2). Could staff clarify why data on the indicative target for end-March 2018 are still missing? Could staff also confirm our reading from MEFP, Table 2 that the indicative target will be transformed into a performance criterion in December 2018? If so, we welcome and support this change and the authorities’ commitment to ensure better outcome in 2018 although we are not sure that the projected floors are realistic as they represent almost four times the December 2017 floor.

We support staff’s emphasis on the need for more decisive steps to deal with the challenges of domestic arrears and the three public banks in distress to enhance confidence and limit fiscal risks. We are concerned, however, by the indication that limited information has been provided by the authorities concerning the structural benchmark on the assessment of options for the resolution of the three distressed public banks. Staff judges rightly that this structural benchmark was not met. However, we note that there is no proposed structural benchmark for 2018 to follow up on this reform. Staff clarification is welcome. In the same vein, could staff elaborate on the rationale behind the recent decision by the government to acquire additional shares in the third largest bank while at the same time a plan is being developed to privatize its non-strategic shareholding?

With these remarks, we and wish the authorities all the success.

Mr. Gonzalez submitted the following statement:

We would like to thank staff for its insightful reports and Messrs. Sembene, Razafindramanana, Nguema-Affane for an informative buff statement.

Gabon continues to face very serious challenges to its economic reform and program success. Completing the adjustment to and recovering from the negative effects of the oil price shock that significantly impacted trade, government revenue, growth and financial stability—ultimately leading to the request of an EFF Arrangement a year ago—remains a priority. In giving our support to the program, we highlighted the strength of the policy response required and noted that crisis was part of the wider difficulties faced by CEMAC countries, requiring a coordinated regional response with support from the international community and multilateral institutions.

So far, the strict path of fiscal adjustment chosen by authorities has had significant implementation problems since last year. December's review was encouraging, as all quantitative performance criteria were met—including exceeding end-June fiscal targets—as were two of the three indicative targets related to non-oil tax revenue and the stock of domestic arrears. But execution of capital spending was below projections, cashflow management problems led to a 50 percent growth in external arrears, and revenue mobilization measures and the target on social spending were missed. Program performance since has remained weak, with none of the indicative targets being met by end-of-year, as was the target for non-oil revenue, and none of the quantitative targets for June 2018 for which there is data. So was the case for new external payment arrears that were missed both in the current and the previous reviews.

We agree that Gabon's difficult economic situation requires urgent and long-term commitment to correction. The country needs a strong policy response based mainly—though not exclusively—on fiscal reform. Debt sustainability, opening space for the private sector to flourish, ending public sector dependence, avoiding the accumulation of arrears and maintaining priority social spending are all key components of a program package.

But the track record of implementation casts doubts on the likelihood of success of a program that rests almost exclusively on fiscal policy. Not only most of program targets were missed, but the political climate deteriorated with the dissolution of parliament, economic performance has been weaker than expected, and social tensions could re-emerge with the introduction of renewed adjustment measures—a point rightly emphasized in the report. We wonder if such a program can realistically be successful even if it contains necessary measures to improve public financial management and safeguard the stability of the financial sector. Could staff comment on the reasons why there where delays in the completion of the report and if they were related to reaching an agreement with authorities? Why was not a detailed explanation of the authorities' position included in in the report? Along the same lines, what is the position of donors and other stakeholders in the international community regarding the progress of the current program and the need for further adjustment? Are there any changes in their commitments and/or requirements to support the current program?

This chair has long argued that restricting monetary policy to defend a currency peg could make a very difficult situation worse. The materialization of external risks would thus weaken CEMAC-member economies further and trigger a costly monetary policy response for recovery that puts even more pressure on the already overly ambitious fiscal targets. But with low inflation, a need for a stronger and more competitive private sector and shared economic characteristics among CEMAC countries, a more detailed analysis of an exchange rate depreciation is necessary even in the absence of these shocks. In the past, staff has avoided providing such analyses by arguing that devaluation is an autonomous policy choice, that there are limits the Fund faces in discussing currency unions, and that currency depreciations have inflationary impacts.

While recognizing these arguments, we still think that the Fund should assess explicitly costs and benefits of moving to a more flexible ER regime and if it would allow for a better calibration of the policy package and for building new lines of defense should the current approach continue to be so difficult to implement. Could staff provide this analysis? Additionally, beyond fiscal policy, what other adjustments in the policy would be advisable to manage the reported risks and increase the possibility of success?

Mr. Merk and Mr. Maluck submitted the following statement:

We thank staff for the candid report and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their informative buff statement.

Gabon's economic performance was mixed with growth stabilizing at a low level. We note that the current account deficit decreased, the fiscal deficit declined and public debt was contained. These positive developments seem, however, mainly due to better-than-expected oil revenues. Reform efforts to structurally increase the resilience of the economy have so far been disappointing. Fiscal consolidation has fallen short of targets and mainly relied on cutting investment expenditure. Non-oil revenues underperformed due to weak program implementation and fiscal slippages have resulted in serious cash flow pressures including renewed arrears to external creditors. The economic outlook remains challenging with a more modest projected recovery of growth, continued tight liquidity conditions and elevated downside risks, which are mainly due to domestic factors, such as potential further slippages in domestic policies in light of a difficult political environment. Against this backdrop, it is imperative that the authorities substantially strengthen their program performance and reform ownership including their commitment to critical social spending programs.

Program-performance at end-December 2017 and through end-June 2018 has been disappointing. At end-December 2017 two performance criteria and all indicative targets have been missed. Staff projects that three performance criteria at end-June 2018 will be missed, while there is no data available for the other two performance criteria. Moreover, progress on implementing structural benchmarks has also been weak with most targets being missed. In addition, despite a prominent commitment made before the completion of the first review, the authorities failed to clear all outstanding external arrears by end 2017, and accumulated additional external arrears in 2018 due to fiscal slippages which aggravated already existing significant cash flow pressures. As staff rightly notes, this risks undermining relationships with external creditors.

We see the significant fiscal slippages as particularly disappointing in the context of the special situation within the Central African Economic and Monetary Community. As the Heads of State previously decided to stick to the exchange rate regime, even stronger progress in other areas is required, particularly in the fiscal domain. Almost all CEMAC member countries have an IMF-supported adjustment program in place and policy assurances have been provided by regional institutions. However, program success first and foremost relies on strong adjustments in the respective member countries and fiscal slippages directly increase the burden of other countries and the regional institutions to safeguard external stability. Gabon as the only CEMAC member country with an EFF-supported program in place – which requires a comprehensive program to correct structural imbalances – should particularly demonstrate strong resolve to put fiscal policies firmly on a sustainable path.

While we acknowledge that corrective measures have been put in place, we are concerned about their adequacy given high implementations risks going forward. We are particularly mindful of the elevated fiscal risks as presented by staff. Given the weak budget execution in the first half of 2018 only a short timeframe is left to achieve the full fiscal adjustment effort for 2018, which puts even higher pressure on achieving short term consolidation gains. As staff rightly points out, the implemented corrective fiscal measures might take more time to produce tangible results, which could potentially result in renewed cash flow problems and consequently in renewed accumulation of arrears. Regarding external arrears, we take note that staff projects that all arrears to bilateral creditors as well as multilateral and guaranteed claims of commercial creditors have been cleared. Moreover, we take note of staff judgement that the authorities are in "good faith" negotiations with all remaining commercial creditors, whose claims are not guaranteed, to clear the arrears by end-2018. Additional staff comments on these good faith efforts – including recent progress towards reaching a collaborative agreement with commercial creditors would be welcome.

The very weak program performance and the continued accumulation of arrears in 2018 have created an increasingly complex program design as new measures have been introduced in a reactive mode to correct past slippages. Against this background, implementation risks loom large. The complex socio-political environment makes reform efforts in some key areas difficult. Staff highlights that fiscal reforms are politically difficult and subject to a substantial risk of reversal. In particular, expenditure measures to contain current spending could create social tensions and might lead to a reoccurrence of strikes in the public sector. Also against the background of the delayed parliamentary election, the risks of additional policy slippages and/or reform fatigue could derail the implementation of corrective measures.

Against this backdrop, we are prepared to consent to the completion of the review only very reluctantly. Notwithstanding the positive corrective measures including six prior actions, we have serious concerns about high risks for program success. The weak previous program performance throughout 2018 and the elevated risks for program implementation highlight the urgent need for the authorities to strengthen program ownership. A clear demonstration of much improved program implementation should be made the precondition for presenting the next review to the board. In this respect, we wonder which criteria would be the basis for the third review, since end-June 2018 PCs have already been part of this review. Staff comments are welcome.

Going forward, we strongly encourage the authorities to bring the fiscal consolidation and the respective composition back in line with program objectives and to reduce public debt accordingly. We take note that budget execution since the start of 2018 has continued on the same trend as in 2017. Both oil and non-oil revenues declined while weaker fiscal controls and new asset acquisitions by the FGIS led to increasing expenditures. We agree that going forward, a decisive implementation of both, revenue and expenditure measures will be needed to achieve the targeted reduction in the overall fiscal deficit. The authorities need to closely monitor fiscal risks. It will be of utmost importance to ensure that no further slippages will occur. Structural fiscal reforms need to be rigorously implemented in order to restore a credible path for fiscal consolidation and to accelerate the clearance of arrears that hamper economic activity.

We thus support staff's call to significantly accelerate the implementation of structural fiscal reforms. Specifically, transparency-enhancing measures, such as expenditure controls, arrears monitoring, and tracking within (semi-) autonomous government entities, need to be strengthened in order to reduce the risk of fiscal slippages. We encourage the authorities to significantly strengthen public financial management and public debt management. Furthermore, we welcome the authorities' commitment to modernize their revenue administration procedures, eliminate unjustified tax exemptions and increase financial oversight of government entities.

We strongly encourage the authorities to safeguard social spending. In light of the socio-economic situation, with one-third of the country's population living below the poverty line, ensuring public support for the difficult adjustment program will be crucial for overall program success. In this context, we would welcome if staff could elaborate on current efforts to protect the most vulnerable groups. Taking note that pro-poor spending has considerably lagged behind program targets, we take positive note of the authorities' commitment to improving social spending, in particular in the field of education.

The breach of the minimum circulation period is regrettable, particularly in light of the authorities' weak track record, which suggests a lack of program ownership, as well as ambitious adjustment needs. We would have welcomed more time to more thoroughly consider this difficult case.

Mr. Virolainen and Mrs. Jekabsone submitted the following statement:

We thank staff for the report and Messrs. Sembene, Razafindramanana, and Nguema-Affane for the informative buff statement. While we note that macroeconomic conditions are slowly improving and there are some encouraging signs of stability, we are deeply concerned about the weak program implementation and substantial fiscal slippages. We can go along with the proposed decisions, on the basis of decisive corrective action by the authorities and adequate implementation of the regional policy assurances. We also recognize the role Gabon's successful program plays in supporting the regional economic strategy of the CEMAC. We broadly share staff's appraisal and would like to offer the following comments for emphasis.

We underline the importance of decisive and effective implementation of the fiscal consolidation plans embedded in the supplementary budget. We concur with staff that an extensive and costly program of custom duty exemptions should be eliminated, and favorable tax treatments removed. The authorities need to safeguard fiscal discipline and ensure expenditure rationalization through reduction of the wage bill, bonuses, and allowances, particularly for senior government officials. Moreover, implementation of firm and timely arrears clearance strategy is essential for effective debt management to avoid accumulation of new arrears. In this context, strong coordination between government institutions as well as continued outreach and dialog across the political spectrum and civil society is critical.

We regret to note that progress on structural fiscal reforms has been limited. Implementation of these reforms is crucial for the efficiency and transparency of public finances. In addition to measures at the central government level, the elimination of a large number of autonomous and semi-autonomous government agencies and efforts to strengthen the fiscal oversight need to be stepped up to restrain fiscal slippages.

Finally, we welcome the authorities' commitment to a better outcome in social spending and protection of the most vulnerable groups in 2018 and encourage them to safeguard social spending going forward.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well-written report and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their insightful buff statement.

Against a backdrop of increased political and social tensions and sluggish regional activity, Gabon's economy is starting to show signs of recovery. With improved oil and manganese export prices, growth is expected to pick up in 2018 and the near term, inflation remains subdued, the twin deficits substantially narrowed, and public debt has declined, although only moderately, from the peak of 2016. We note, however, that performance under the ECF-supported program for end-2017 and through June 2018 was mixed, and that, notwithstanding a shortfall in revenue, the decline in the fiscal deficit in 2017 resulted largely from cuts in investment spending, including foreign-financed investment, which adversely impacted the economy. While the medium-term outlook remains favorable, subject to continued reform momentum, risks are skewed to the downside, stemming from lower oil prices, accumulation of new domestic arrears, poor policy-driven fiscal consolidation, and further fiscal slippages amid social resistance to reforms. We are in broad agreement with staff appraisal and, based on the strength of the corrective actions taken by the authorities to keep the program on track, support the proposed decision.

We commend the authorities for their commitment to timely implement the critical fiscal reforms announced in the MEFP, and call for a swift return to a credible fiscal consolidation path. We welcome the approval of the 2018 supplementary budget, which could help pave the way for a strengthened fiscal adjustment, while restoring fiscal discipline and preserving fiscal and debt sustainability. We look forward to firm implementation of the proposed fiscal package, including measures to increase non-oil revenue and rationalize expenditure. We are comforted by the clearance of all external arrears to official bilateral as well as multilateral and guaranteed claims of commercial creditors, and look forward to the clearance of the remaining arrears by end-2018, as well as effective measures to clear newly accumulated arrears and prevent further accumulation. The introduction of the new system to manage contingencies and fiscal risks is encouraging.

The banking sector has been suffering from high NPLs, which impair banks' ability to play their role in promoting economic activity while threatening financial stability. We remain concerned by the three public banks in financial distress, and would appreciate staff comments on the fiscal costs of their liquidation/resolution. We call for stepped up efforts in implementing the authorities' new financial sector reform agenda.

We support the authorities' intention to speed up the reform momentum to strengthen macroeconomic stability and foster sustained growth and economic diversification, as indicated by Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane. We welcome their commitment to further strengthen PFM, improve the business environment, and promote competitiveness. In this regard, the recent surge in FDI, including in agri-business and other nontraditional sectors, is encouraging. We support the authorities' pro-poor initiatives and their efforts in safeguarding social spending. Improved coordination among government institutions, as intended, along with strong external support will be crucial for the success of the authorities' policies.

Ms. Horsman, Ms. McKiernan, and Ms. Zorn submitted the following statement:

Macroeconomic stability appears to be taking hold in Gabon. Moreover, as noted in Messrs. Sembene, Razafindramanana, and Nguema-Affane's helpful buff statement, longer-term prospects for stronger, sustainable growth look promising, contingent upon the successful completion of Gabon's Economic Recovery Program. However, program performance since the latter part of 2017 has been disappointing, and there are substantial downside risks in the short term. We welcome the authorities' affirmation of a strong commitment to the program, and would emphasize the importance of timely implementation of agreed measures to demonstrate this commitment. The recent completion of several structural reforms, the adoption of six prior actions, and the described plans to strengthen monitoring, manage social resistance to budgetary changes, and achieve cooperation at the highest political echelons, all suggest that the program may be back on track. We also note that union-level institutions have been delivering on their policy assurances. With these considerations, we can go along with the completion of the second review and requested waivers. We agree with the thrust of staff's assessment and offer a few additional comments for emphasis.

Avoiding fiscal slippage is critical for the success of the Economic Recovery Program (PRE). The authorities deserve some credit for reducing the overall fiscal deficit and reducing total public debt in 2017. Going forward, it will be important to achieve the targeted non-oil fiscal balance, by boosting non-oil revenues and reducing non-social spending across government agencies, while also protecting public investment. The streamlining of customs duty and other tax exemptions, increased focus on tax compliance, and selective measures to reduce the wage bill could produce desired results relatively quickly. Contingency measures, such as an automatic expenditure adjustment mechanism that is triggered by revenue shortfalls, will add an important layer of expenditure control as long as execution is well coordinated across responsible departments. However, as staff point out, some of these initiatives will be politically difficult, so careful, ongoing public communication will be critical along with steadfast implementation.

Structural reforms aimed at strengthening public financial management and enabling greater private sector activity are the necessary complement to fiscal adjustment. We note the government has agreed to take strong action to accelerate implementation of delayed fiscal structural reforms that will strengthen adherence to revenue and expenditure targets. We emphasize the importance of meeting the agreed floor on social spending, and, in this regard, welcome plans to improve outcomes through increased reporting and better program targeting. Based on the findings from the first PRE progress report, the authorities are appropriately focusing on building investor confidence through reforms that support the ease of and protections for doing business.

It is important to protect the progress made on arrears reduction in order to achieve program targets, meet CEMAC convergence criteria, and support investment activity. We welcome the reduction in the stock of external arrears, particularly to official bilateral and multilateral creditors, as well as the operationalization of the Club de Libreville arrangement to manage domestic arrears. In addition to intended revenue and spending measures, careful cash flow management, monitoring, and reporting will help to ensure sufficient liquidity to meet government obligations and prevent further arrears accumulation.

The increase in financial sector vulnerabilities through the first quarter of this year, particularly in relation to NPLs, is concerning. While the framework for payment of domestic arrears to small and medium-sized enterprises will help, more rapid progress on financial sector reforms and on the resolution of NPLs is needed to support credit provision and economic activity.

Mr. Armas and Ms. Moreno submitted the following statement:

We welcome the staff report as well as the letter of intent from the authorities. Particularly, we are encouraged by the authorities' clear commitment to achieve their fiscal objectives in 2018, as well as the renewal of the commitment to pursuing the arrears strategy. In addition, all prior actions have been met for the completion of the second extended fund facility. Therefore, even though the risks for the program implementation are high, we support the decision to waive the nonobservance of performance criteria and the waives of applicability on the basis of corrective measures, and financing assurances review. We, nevertheless, encourage the authorities to continue their efforts to complete the agreed measures, especially those to better manage fiscal risks.

Debt is expected to remain sustainable against a backdrop of lower economic growth. Modest growth is explained in part by the oil sector, but mainly due to the larger than expected negative impact of the fiscal consolidation. On the positive side, foreign direct investment (FDI) has been flowing into sectors other than from oil, and is expected to remain favorable in the medium term. How is the FDI outlook compatible with a modest output growth projection combined with the need to foster essential structural reforms? Staff's comments are welcome.

The issue of increasing non-performing loans in the banking sector is a matter of concern even though the system is assessed as sound. We commend the authorities to tackle the issue in its origin as credit will likely increase, as staff recognizes, making the problem potentially larger. Also, the fact that some banks need to be resolved adds pressure to the performance of the system; so, we encourage the authorities to continue looking for solutions.

Structural reforms, as the authorities recognize in their buff statement, will be aimed at bolstering competitiveness, economic diversification and restoring private sector confidence. Nevertheless, we agree with staff, and we welcome that authorities agree as well, that the critical reforms are needed in the fiscal sector. One key element is revenue mobilization. The reforms need to be implemented urgently not only to comply with the commitments to the Fund program, but to sustain medium term growth.

Mr. Claver-Carone and Ms. Svenstrup submitted the following statement:

Amid socio-political constraints, Gabon's economic position remains fragile. Growth is low and dependent on commodities, and the fiscal strategy has been unsustainable. Exacerbating the situation, Gabon's program performance since December has been weak, with significant delays and slippages raising serious concerns about program ownership. We are particularly troubled by the increase in the non-oil primary basic deficit, the accumulation of new external arrears, and the missed targets on social protection spending and non-oil tax revenue. It is imperative that the authorities take immediate and persistent actions to avoid further arrears accumulation, reverse fiscal slippages, and ultimately lay the foundation for more sustainable non-oil growth and job creation. Moreover, as one of the largest members of CEMAC, the regional stabilization strategy will not be successful if Gabon fails to fully implement its fiscal consolidation and structural reform agenda.

In light of these concerns, it is with regret that our chair wishes to be recorded as abstaining on this decision. The 2018 Supplementary Budget provides a window of opportunity for the authorities to get the program back on track, and the completion of the five additional prior actions is a preliminary indication that the authorities are now taking program implementation more seriously. We hope to see this recent trend continue so that we can support a third program review that demonstrates substantially improved performance. Specifically, we would like to see all the end-September indicative targets substantively on track, and progress made on measures to strengthen public financial management, improve tax collection, and rationalize and reduce tariff exemptions – all as outlined in the MEFP. Staff rightly emphasize the risk that socio-political pressures and unrest may continue to delay measures – careful messaging to the public and to key stakeholders, as well as a more robust social safety net, will be critical to sustain reform momentum in this context.

Turning to specific policy issues, we generally agree with staff's recommendations and underscore the following points for emphasis:

Recent fiscal consolidation, while significant at the overall level, has been predicated on deep cuts to public investment expenditures, further weighing on growth. We welcome the measures announced in June to rein in public wages, improve customs tax collection, and better track expenditures through the E-BOP system – all of which will provide the basis for more sustainable, transparent, and growth-friendly fiscal policy going forward. We notice that the structural benchmarks for 2018 (MEFP Table 4) do not include any follow-up measures in these three areas. Could staff comment on how the program will monitor the authorities' ongoing efforts and promote further reform implementation in each area? Could staff provide more insight on whether the level of coordination between the Ministry of Economy and Budget Ministry is sufficient to align revenue collection and expenditure execution in support of a cohesive overall fiscal strategy?

The accumulation of new external arrears since December is particularly troubling and suggests substantial risks in multiple areas of program implementation. We urge the authorities to put in place a firm and timely strategy to better manage cash flows to clear arrears and, critically, avoid the accumulation of new arrears. The fiscal reforms described above will be helpful in this regard, as will the contingency measures included in the 2018 Supplementary Budget. We also urge the authorities to continue to strengthen debt and cash flow management to meet payment obligations. To this end, we look forward to the finalization of the of the independent audit of government arrears by end-September, which will be a helpful step in improving transparency of debt management.

We welcome the authorities' efforts to improve the monitoring, reporting, and efficiency of social spending. As part of the fiscal strategy, we urge the authorities to make all efforts to prevent further cuts to, and look for ways to increase, pro-poor spending. It will be important that new social protection programs are well designed, well-targeted, and transparent to direct scare resources to those most in need. For example, we note that the remaining customs exemptions are targeted towards select pro-poor items. Could staff discuss the progressivity of the remaining items on the customs list and confirm that the exemption list has indeed been made public to ensure accountability?

Finally, successful implementation of Gabon's reform program is interlinked with economic stability in the CEMAC monetary union. As in the case of other CEMAC country program reviews, full implementation by BEAC and COBAC of the policy assurances outlined in Policy Support Letter is necessary to provide the underlying external conditions in support of reform implementation in Gabon. We therefore expect that these critical policy assurances will be completed by the time of the third program review.

Mr. Agung, Mr. Johnston, Mr. Sun, Ms. Lok, and Ms. Ong submitted the following joint statement:

We thank staff for the comprehensive report and Messrs. Sembene, Razafindramanana, and Nguema-Affane for their informative buff statement. Program performance in the past six months has been weak, but we can support the proposed decision given the strong corrective actions taken. Strong program ownership and close coordination across national and regional stakeholders will be critical in putting the program back on track. Effective prioritization and sequencing of reforms are also vital.

Urgent efforts are needed to bring the fiscal adjustment path back on track. Non-oil revenues underperformed and new external arrears were accumulated during the review period. The authorities have undoubtedly made strong efforts to resolve external arrears ahead of the Board meeting, but we underscore that decisive efforts are needed to prevent their recurrence. Fiscal adjustment should focus on containing inefficient expenditure and mobilizing non-oil revenue, while structural fiscal reforms need to be accelerated. We welcome the structural measures in the pipeline, especially steps to improve control of special accounts spending, enhance liquidity management, and rationalize tax and customs exemptions. As more resources become available, they should be channeled toward productive public investment. We are also concerned that the indicative target on social spending has again been missed and by a larger margin. The re-emergence of social tensions could challenge the authorities' ability to enact reforms. With the assistance of the World Bank, we hope the efforts by the authorities to enhance predictability and quality of social spending will bear fruit.

Financial sector reform appears to be lagging. The three distressed public banks pose fiscal risks and we call on the authorities to work with COBAC towards their timely resolution. While the banking sector remains broadly sound, rising NPLs will weigh on banks' ability to extend credit to the private sector. We encourage the authorities to step up their efforts to tackle the stock of NPLs and domestic arrears. Could staff provide more information and share their views on the Club de Libreville arrangement?

The success of this program depends on the implementation of supportive policies and reforms by regional institutions. We agree that the three regional policy assurances are critical to the success of the program, and that the completion of the third review be conditional on the implementation of these measures. However, we wonder if this region-level conditionality should be formally recorded alongside the program documents, rather than appearing only in the staff appraisal. The summing up of the program design in currency unions discussion says that assurances from currency union institutions "will be part of the program documentation, and published following a similar approach to the one that applies to the publication of policy intention documents from the national authorities". Staff comments are welcome.

Finally, while we understand that end-June PCs have become controlling, it is not optimal from a governance perspective for the Board to grant waivers based on data that is lacking or not final. We encourage staff and the authorities to prevent similar delays in the next review.

Mr. Saito and Mr. Ozaki submitted the following statement:

We thank staff for the informative papers and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their insightful statement. We welcome that macroeconomic conditions in Gabon have begun to improve gradually, notably with welcome signs of economic stabilization. In particular, it is encouraging that we see robust economic activity in new sectors. The authorities' efforts to attract new investments in the non-oil commodity sectors (manganese, forestry), the special economic zone and agribusiness have been positive, which is contributing to the diversification and resilience of the economy. We positively take note that the recently approved supplementary budget would facilitate a robust fiscal contribution. However, we strongly concur with staff's view that the authorities need to improve their track record of implementing program commitments. It is regrettable that the program performance since the first review fell below expectations. While the authorities remain committed to the objectives of their Fund-supported program, we urge the authorities to tackle the reform in a timely manner. We also reaffirm that the implementation of BEAC and COBAC's policy commitments and newly provided policy assurance will be critical for the continuation of IMF financial support as part of the IMF-supported programs with CEMAC members.

Fiscal Policy

It is unfortunate that program performance since December 2017 was weak. We note that the target for the non-oil primary balance and the continuous PC on external arrears were missed, and the three indicative targets on non-oil revenues, social spending, and domestic arrears were also missed at end-December 2017 by relatively large margins. We also observe that the composition of the fiscal adjustment in 2017 was problematic, and that while the overall fiscal deficit improved, this masks substantial fiscal slippages that are best captured through other fiscal indicators.

In this regard, decisive revenue and expenditure measures are necessary to restore a credible path for fiscal consolidation and to accelerate the clearance of arrears that is hampering economic activity. Considering the deviations in fiscal execution from the original plans generated substantial cashflow pressures, the implementation of fiscal consolidation plans, effective cash flow and debt management, as well as stronger coordination between government institutions is critical. In particular, a credible cash flow strategy is crucial for the authorities to prevent further arrears accumulation over the next years.

Managing External and Domestic Arrears

We appreciate authorities' efforts to reduce the stock of external and domestic arrears, in particular we welcome that the authorities have cleared all external arrears to official bilateral creditors as well as multilateral and guaranteed claims of commercial creditors in July ahead of the completion of the second review. Having said that, we need to recall that all external arrears should have been cleared by end-December 2017. The supplement paper issued just one day before the board (EBS/17/128, Supplement 1) mentioned that “the authorities remain committed to clearing all remaining external arrears by end-December 2017.”, which indicated that the authorities (and staff) believed they could clear all the external arrears if the completion of the first review made available a purchase. Staff also mentioned at the last board that several disbursements including the Fund disbursement are useful to clear some of the commercial arrears. In this connection, staff briefly mentioned several reasons in para 8 of the staff paper for the failure to meet the commitment under the Fund-supported program to clear all external arrears at the end of 2017. However, these reasons seemed to be already predictable on December 20, 2017. Against this background, could staff elaborate more on the reasons of the failure to clear all the external arrears by the end of last year? Didn’t staff recognize the reasons mentioned in para 8 at that time? Did the situation suddenly change after the first review board?

When it comes to domestic arrears, we positively take note that a new “Club de Libreville”, a payment plan used in the past to clear domestic arrears, has been agreed in April 2018 to settle a large share of domestic arrears to small- and medium-sized enterprises over the next six years, according to the buff statement. In this connection, could staff share the view about the inconsistency with staff’s responses to technical questions (No.18) at the first review in terms of the duration (i.e. The program assumes the clearing of domestic arrears over a four-year timeframe)?

In this connection, the authorities have started to hold regular meetings to update their monthly cash flow plan of revenues, expenditures, loan disbursements, debt repayment schedules, and the remaining arrears clearance plan to avoid short-term liquidity shortfall and the risk of re-accumulation of arrears. While it is a welcoming step, it might be better to consider further systematic measures, such as concentration of capacity to owe debt into a single Ministry. Staff’s comments are welcome.

We have concerns that structural measures to avoid accumulation of new arrears were not implemented on schedule, including adaptation of the expenditure control system to cover local administrations. Measures to improve cash management, prepare cost-benefit analysis for new large investment projects, and produce an annex to the 2018 budget law on tax exemptions were also delayed. While tax and customs IT systems were adapted to eliminate illegal exemptions, some steps are still pending to make the reforms fully operational. In this regard, as for the assessment of capacity to repay the Fund, staff stated that although public debt is expected to remain high during the program period, strong program implementation would put it on a firm downward path. When we see the recent track record of implementing the structural measures, it is not fully convincing that strong program implementation, the prerequisite for the capacity to repay the Fund, would be ensured. Could staff elaborate more on the adequacy of the capacity to repay, considering the recent track record of implementation?

Safeguarding Social Spending

We commend that the authorities are taking steps to improve monitoring and reporting of social spending. We note that the indicative target on social spending was missed at end-December, 2017. A stronger commitment to critical social spending programs will also be critical to increase social acceptance and sustain reform efforts over time. This will help offset the impact of the fiscal consolidation program and ensure that vulnerable groups are adequately protected. We encourage the authorities to respect legal provisions that limit modifications of the budget composition during its execution to ensure that allocations to social expenditure are executed in compliance with the budget law.

Mr. Panek and Mr. Waelti submitted the following statement:

We thank staff for their comprehensive report and Messrs. Sembene, Razafindramanana, and Nguema-Affane for their informative buff statement. Policy adjustment and structural reforms at the national level are a key element of the regional strategy aimed at restoring macroeconomic stability, rebuilding buffers, and promoting higher and more inclusive growth. We recognize that progress has been made in the CEMAC region as a whole. That said, performance under Gabon’s Fund-supported program has fallen short of objectives on many counts, amidst substantial fiscal slippages, renewed external arrears accumulation, lingering weaknesses in public financial management, and rising financial vulnerabilities. Lack of adequate ownership and insufficient policy implementation are manifested by the fact that two out of five performance criteria and all indicative targets were not met at end-December 2017, while all end-June 2018 performance criteria for which data were available have not been met. We underscore the key role of program conditionality as a risk-mitigating measure to safeguard Fund resources.

Fiscal discipline needs to be restored to ensure debt sustainability and avoid accumulation of new arrears. We note with regret the decline in non-oil revenues and the inappropriate change in the composition of public spending. Strong and sustained measures to enhance domestic revenue mobilization are urgently called for. Expenditure rationalization should ensure sufficient space to meet pressing social and public investment needs. In this vein, we agree with staff on the importance to avoid automatic cuts in priority social spending programs and to limit the impact of the expenditure reduction on public investment.

Long-standing and deeply entrenched weaknesses in public financial management must be addressed more forcefully. We note with regret that progress on structural fiscal reforms to date has been limited. Could staff elaborate on possible capacity constraints in this regard? We emphasize that deep and sustained measures remain necessary to significantly improve public financial management. The staff report lists reforms on many fronts. Could staff elaborate on the appropriate sequencing for the introduction of the proposed fiscal structural measures?

Banking sector weaknesses must be tackled with a greater sense of urgency and with more determination. We note staff's disappointment at the slow pace of financial sector reforms in light of rising financial sector vulnerabilities. We are surprised that the resolution of the three public banks seems not to have advanced since the last program review. Staff's comments would be appreciated. Meanwhile, non-performing loans continue to rise. Further and urgent efforts are needed to avoid an undue contraction in credit provision.

Mr. Mahlinza, Ms. Gasasira-Manzi, and Mr. Essuvi submitted the following statement:

We thank staff for their informative report and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their insightful buff statement.

The Extended Fund Facility (EFF) arrangement implemented since June 2017 is playing a critical role in restoring macroeconomic stability in Gabon. Despite a difficult economic environment, the authorities are taking the necessary steps to build resilience and support economic recovery. In particular, following program implementation challenges experienced in 2017 and early 2018, the authorities have now put in place measures to address the tight liquidity situation and restore the programmed path of fiscal adjustment.

Against this background, we support the completion of the Second Review of the Extended Arrangement Under the Extended Fund Facility, Requests for Waivers of Nonobservance of Performance Criteria and Waivers of Applicability, and Financing Assurances Review.

Fiscal consolidation is critical to guarantee debt sustainability. To this end, consolidation should be conducted so as not to affect social programs and essential infrastructure needed to promote medium-term economic growth. That said, we note the measures implemented in 2017, which resulted in a reduction of the overall fiscal deficit. We welcome the fiscal plans embedded in the 2018 Supplementary Budget including the elimination of illegal tax exemptions, the introduction of new taxes, expenditure rationalization measures and reform of the wage bill. Going forward, we encourage the authorities to modernize the Public Finance Management (PFM) system to make it more efficient and transparent through better budget preparation, targeted controls on budget execution, introduction of a more comprehensive and accurate fiscal reporting system, and improved access to budget information.

Clearance of arrears remains a priority to bring debt down and support credit growth. As arrears appear to have become a drag on economic growth, we encourage the authorities to quickly implement their arrears strategy while putting in place measures to avoid further accumulation of arrears. Could staff provide comments on the strength of the authorities' plan and the challenges involved to decisively bring down arrears and avoid their further accumulation.

Financial sector monitoring should be strengthened. While financial indicators show that the banking sector is well capitalized, we note that the situation of the three public banks in financial distress has deteriorated since 2015, with two already in liquidation and the other under management. We are encouraged by the authorities' efforts to step up recoveries and write-offs by banks, enforce collateral guidelines, and ensure strict oversight of banks' credit risk management frameworks and lending policies. While capital adequacy ratios continue to meet minimum standards and the banking sector remains broadly sound, we urge the authorities to expedite efforts aimed at strengthening the legal and supervisory framework for non-performing loans (NPLs).

The implementation of structural reforms is critical to support sustainable economic growth. We encourage the authorities to accelerate the implementation of reforms to promote economic diversification and inclusive growth. In this connection, we welcome efforts to improve the business climate including the approval of a new framework for private public partnerships (PPP) to increase the attractiveness of private investment in special economic zones (SEZ). In addition to reforms to support private sector development and diversification of the economy, the authorities should continue to strengthen the legal and regulatory environment including through accelerating the operationalization of the new arbitration chamber for business disputes and modernizing the credit registry.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for an informative paper and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their insightful buff statement. Gabon's macroeconomic conditions are gradually improving and growth is set to recover going forward, supported by stronger activity in some non-oil commodity sectors and recovery of oil prices. Macroeconomic imbalances are abating with simultaneous reduction of current account deficit and fiscal deficit, while inflation is contained at a low level. Gabon's implied reserves at the BEAC have increased recently, contributing to higher regional external stability. At the same time, recovery remains fragile and vulnerable to policy slippages. Hence, the implementation of the program requires from the authorities' decisive efforts to strengthen public finances, ensure sustainable fiscal consolidation, and improve business environment.

Risks to the program remain elevated. Program implementation has been mixed at best, with several end-December and end-June performance criteria and indicative targets not met. We note that the authorities have recently strengthened program monitoring and introduced a package of corrective measures to address most urgent fiscal slippages and improve fiscal performance going forward. In view of these corrective actions, we can agree with the staff recommendations and support the proposed decisions. We would like to make a few comments for emphasis.

Macroeconomic stabilization and success of the program critically depend on achieving a durable fiscal adjustment. As non-oil revenues deteriorated substantially in 2017, the authorities responded by reducing dramatically capital expenditures and, to a lesser extent, current spending. These measures allowed to halve the overall fiscal deficit to 3.4 percent of GDP but not in a sustainable manner. In this regard, the recently approved supplementary budget was a step in the right direction, as it emphasized the improvement in non-oil primary budget through better revenue performance and strengthened public expenditure management.

We commend the authorities' efforts to boost revenue, including the elimination of ineffective program of customs duty exemptions and rationalization of tax expenditures. These steps should be complemented by substantial strengthening of revenue collection capacity, including tax and customs administration. On the expenditure side, the emphasis should be on reducing ineffective current expenditure to create room for the priority public investments and social spending. We note that the program envisages a reduction of the overall fiscal deficit of 3.1 percent of GDP in 2018 on top of similar reduction observed in 2017. This may be an ambitious target, given still weak implementation capacity and fragility of social and economic situation. We would welcome staff comments on the feasibility of the fiscal consolidation target and possible risks in this area.

The clearance of all external arrears and a substantial reduction of domestic arrears are important for restoration of trust and recovery of investment. It is disappointing that the authorities did not honor their commitment to clear all external arrears by end-2017 and accumulated new arrears. We note that the authorities have recently taken steps to address the arrears issue, including the clearance of external arrears to official creditors and the adoption of the "Club de Libreville" payment plan for domestic arrears. To fully eliminate arrears and prevent their accumulation in the future the authorities should improve overall fiscal performance and strengthen the debt management system.

With these remarks, we wish the authorities success.

Mr. Fachada and Mrs. Buteau Allien submitted the following statement:

We thank staff for a well-written report, and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for their statement. Program performance in Gabon has been mixed in the recent past, marked by fiscal deterioration—measured by the non-oil primary basic balance—and accumulation of new external arrears. We take note, however, that the new Gabonese government has reaffirmed its commitment to the program and prior actions for this review have been met. We therefore support completion of the second review under the Extended Fund Facility (EFF), including the waivers of nonobservance of performance criteria. We agree with staff that Gabon's medium-term outlook remains favorable provided appropriate policies are implemented, underpinning the need for close program monitoring in a context of significant downside risks.

Accelerating key reforms for fiscal consolidation will support program implementation. We welcome the authorities' efforts towards increasing revenue collection amid still weak economic activity, while maintaining the wage bill strictly under control. We agree with staff that decisive revenue and expenditure measures are necessary to restore a credible path for fiscal consolidation, given the unexpected increase last year of the non-oil primary basic deficit. In this regard, we recommend addressing weaknesses in public financial management and cash management, and better use cost-benefit analysis for priority investment spending. Debt management efforts remain crucial to reduce domestic and external arrears.

Financial sector vulnerabilities should be addressed as they pose substantial risks to the outlook. Although the banking system seems adequately capitalized in general, non-performing loans have increased on the back of low economic activity, provisions have remained low, and bank deposits have contracted. We emphasize the need to address the situation of the three distressed public banks, and take note that the structural benchmark regarding the assessment of solutions aiming at resolving or restructuring the three institutions has not been met. Can staff provide additional information about the hiring of an international consultant to assess options going forward for the two public banks in liquidation? Against the background of financial stability risks and fiscal restraint, we were surprised that the authorities decided to increase their stake in one banking institution. Staff's comments would be welcome.

New policy assurances provided by BEAC and COBAC are expected to sustain program implementation. While we welcome the authorities' decisive steps to renew program ownership and commitment, we encourage staff to remain engaged and continue to provide appropriate technical assistance geared towards effective policy implementation.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed papers and Mr. Sembene, Mr. Razafindramanana and Mr. Nguema-Affane for their informative buff statement. Macroeconomic conditions are improving gradually in Gabon with positive growth, stable inflation, lower budget and current account deficits and strengthening external reserves. However, fiscal pressures, tight liquidity conditions and accumulation of arrears coupled with persistent social tensions and political risks have made sustaining a recovery a difficult task. We commend the authorities' for making efforts under trying conditions to push forward the reform initiatives.

Staff has assessed the program performance as weak. Two end-December 2017 performance criteria (PCs) and all three indicative targets (IT) were missed. Many delayed structural benchmarks (SBs) were met. The continuous performance criterion on external arrears accumulation has not been observed consistently. Hence, we are concerned about what this record reflects about the program design and implementation capacity. We support the completion of the second review under the EFF, waiver of applicability for some end-June performance criteria and other proposed decisions based on the recent corrective measures, staff recommendation and the renewed commitment expressed by the authorities in the buff Statement. At the same time, given the downside risks to the program, we emphasize the need to remain committed to meet program objectives and achieve a durable medium-term recovery. Continued outreach and dialogue with political and civil society stakeholders, improved coordination among institutions and clear communication are also vital to mitigate tensions and manage risks. We concur with staff assessment and recommendations, and wish to highlight following points for emphasis.

Decisive and steadfast implementation of the announced fiscal reforms is paramount to preserve fiscal and debt sustainability and restore macroeconomic stability. We positively note the strong policy package aimed at an adjustment equivalent to 3.1 percent of GDP in the overall fiscal deficit (cash basis) in 2018. However, we are not fully convinced about the ability to achieve this stronger adjustment target given the developments thus far in 2018 and the fragile conditions, including social tensions. Could staff comment? Going forward, averting severe deterioration of revenues while making efforts to increase non-oil revenue should remain the key priority. We look forward to the progress on efforts to rationalize and control tax exemptions, recover tax arrears, and improve tax and customs administrations. Maintaining spending discipline with enhanced transparency, efficiency and rigor is also key to preventing ad hoc cuts in investment expenditure to maintain fiscal targets and avoid arrears accumulation. We welcome the use of Club de Libreville payment plan to settle a large share of domestic arrears (of about 5 percent of GDP) to SMEs over next six years. Could staff comment on the impact of this plan on the cash flow and the overall budgetary process? We agree that efforts to reduce wage bill are in the right direction. However, the non-meeting of the IT on flow on social protection spending by end-December 2017 is a concern and we emphasize the need for providing adequate resources for social spending to protect vulnerable people as well as to education, health and infrastructure development to support sustainable growth. Could staff comment on this? We welcome the automatic adjustment mechanism to alter expenditure based on the non-oil revenue performance to reduce fiscal risks.

The reinforcement of cash flow management and strengthening of debt management will help effectively manage tight financing needs and address liquidity pressures, reflected by the high debt service ratio to reserves and exports. We support the plans to consolidate public financial management measures introduced since 2015 to strengthen government finances.

The banking sector is adequately capitalized and remain generally sound, but further efforts are needed to preserve financial system stability and support the growth process. We note the growing NPLs and stress the need for acceleration of developing a framework for NPL resolution. The timely resolution of three distressed state-owned banks will help reduce vulnerabilities. We would welcome staff comments on the provision of incomplete information by the authorities concerning the SB on the assessment of options for the resolution/restructuring of the three distressed public banks, indicated in para No. 10. We welcome the assurance of support by union-wide institutions (BEAC and COBAC) to implement complementary policies, which are critical to the stability, program success and economic development in Gabon.

Structural reforms aimed at bolstering competitiveness and economic diversification are important to restore private sector confidence and reduce the reliance on oil exports. We see a critical need for greater reforms to build a fair and transparent business environment to attract more FDI to agri-business and other non-traditional sectors to become major drivers of growth to reduce dependence on oil. In this context, we welcome the initiatives, including the land titling reforms, which are vital to unlocking private sector potential. Improving human capital and the quality and cost of core infrastructure are also critical building blocks for economic diversification.

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

Ms. Erbenova, Mr. Just, and Mr. Hagara submitted the following statement:

We thank staff for the informative report and Messrs. Sembene, Razafindramanana, and Nguema-Affane for their buff statement. The economic activity in Gabon is slowly stabilizing broadly in line with staff’s projection at the program request a year ago, while oil and other commodity exports helped narrow the current account and fiscal deficit. Nevertheless, we are deeply concerned by the weak program performance in late 2017 and the first half of 2018. Against numerous downside risks, bold corrective measures are necessary for the viability of Gabon's program, which is also key to support the CEMAC regional economic strategy, as well as program performance in other CEMAC countries.

Decisive fiscal consolidation is core to the stabilization efforts. Revenues have continued to underperform in 2018, while expenditures exceeded program projections, translating into higher net lending, liquidity pressures, and the accumulation of external and domestic arrears. We welcome the introduction of the quantitative performance criterion on the tax revenue floor, and accordingly, the 2018 Supplementary Budget is a step in the right direction in mobilizing non-oil revenues through streamlining tax expenditures and custom duty exemptions. Also, the tighter control of special accounts spending and the wage bill reduction as part of the Supplementary Budget are, in principle, welcome. Nevertheless, parts of the measures are reactive and of an across-the-board nature. The original program targeted, for instance, a more gradual wage bill reduction, based on the review of remuneration policies and the systematic retirement of civil servants. We thus concur with staff on the inherent risks and believe that further adjustments might become necessary to make fiscal gains sustainable over the medium term. Staff comments on how much the World Bank's technical assistance on public sector wage bill in December 2016 benefited the recent wage bill reduction measures are welcome.

The public financial management framework (PFM) needs to be substantially strengthened. We appreciate the authorities' efforts to address the official arrears, making today's Board discussion possible, although with delay. In view of the apparent substantial deficiencies in the liquidity, debt, and PFM frameworks, we strongly support the introduction of new PFM structural benchmarks and urge the authorities to implement them expeditiously, while at the same time advancing the fulfillment of the still unmet structural benchmarks from the First Review. We also note that the original program envisaged the mobilization of CFAF 50 billion privatization receipts in 2017, which was postponed and assumed as a contingency measure for 2018 within the First Review. While the authorities face a very tight liquidity position, the Second Review assumes even lower privatization receipts in 2018. We would welcome more details on what steps have been taken so far and which state-owned enterprises/properties are ready to be privatized to realize these privatization receipts.

The banking sector vulnerabilities need to be addressed without delay. The three distressed state-owned banks are not systemically important, but their resolution needs to be expedited to minimize fiscal costs. We also share staff's concerns about the government's recent acquisition of additional shares in the third largest Gabonese bank. Any further support to small- and medium-sized enterprises should be channeled through scrutiny of commercial banks to better identify viable projects. At the same time, the rising non-performing loans call for stronger legal and supervisory frameworks.

Mr. de Villeroché, Ms. White, Mr. Bellocq, and Ms. Stockill submitted the following joint statement:

We thank staff for their comprehensive set of reports and Mr. Sembene, Mr. Razafindramanana and Mr. Nguema-Affane for the insightful buff statement.

As underscored by staff, the program's performance has been weak and far from expectations since December 2017. While regretting this situation, we do note that a number of corrective actions were recently undertaken to bring the program back on track. We welcome the 2018 Supplementary Budget of June 29th which was necessary after the fiscal slippages observed in the first half of 2018. Moreover, staff also note that many measures recently taken to restore the program's credibility were designed by a new intergovernmental task force endorsed by the President. Moving forward, we expect this task force to increase national ownership of the program. Against this challenging background, we support the completion of the second review of the Extended Arrangement under the Extended Fund Facility, as well as the waivers of Nonobservance of Performance Criteria. We strongly encourage the authorities to improve the program performance, and in particular to improve the composition of the adjustment by protecting social spending and growth-friendly investment, while enhancing non-oil revenues and streamlining current spending. This will be paramount both to limit the impact of the adjustment on growth and to improve the social acceptability of the much needed reforms.

On the fiscal side, staff accurately point out weaknesses in the composition of the adjustment last year. Indeed, while of a significant magnitude, the adjustment was associated with a decline of total revenues (with a sharp drop of over 2 percent of GDP for non-oil revenues), an increase of the non-oil primary balance, an accumulation of new arrears, and missing the social spending target at year-end. Going forward, we call for a balanced fiscal consolidation relying mainly on revenue-side measures and well targeted expenditure side measures. In that regard, the fiscal measures proposed for the second half of this year appear appropriate, with a mix of tax exemptions elimination and expenditure rationalization (including the very welcome elimination of ghost workers). The size of the fiscal consolidation expected for the second semester is however significant, as it partly corrects for past slippages, and it is not clear the impact on growth will be as minimal as assessed by staff. In any case, we urge the authorities to meet program targets on social spending, as poverty and social inclusion remain critical issues in this resource-rich country. Regarding poverty, the staff report prepared for the first review of the Extended Arrangement stated that plans were underway to complete a new poverty survey with preliminary results expected in early 2018. Does staff have any information to share with the board on this new survey?

The clearance of all external arrears to official bilateral and multilateral creditors in July is welcomed, but further progress is needed to avoid the reemergence of external arrears and to clear all domestic arrears. As pointed it out in the staff report, avoiding the accumulation of new external arrears is critical to preserve good relationships with external creditors and development partners. We also agree with staff that strengthening public cash flow management is paramount for mitigating the risk of new arrears accumulation. In this regard, we note that measures aiming at improving cash management, and covered by related structural benchmarks, were delayed. This is concerning given the urgent priority placed on improving cash management in the first review. Could staff provide us with further details on the reasons for such a delay and on how the program will support the authorities in this area going forward?

Structural reform implementation should be strongly improved going forward. Significant progress is expected in the coming months with regards to tax revenue administration, rationalization of exemptions, Public Finance Management reforms, and public investment management. Regarding public investment management, as noted in our written statement issued for the first review, we hope to see the systematic inclusion of cost-benefits analyses of major projects in the budget law (as expected under the dedicated Structural Benchmark). We note positively that the government remains committed to joining the EITI even if progress has stalled so far.

All in all, even if economic growth is expected to pick up somewhat this year, the short-term outlook remains very challenging. Staff rightly underline that program implementation is becoming complex because of reactive measures introduced to compensate for sizable fiscal slippages and cash flow constraints. We also agree with staff that the social sustainability of the revised budget could be an issue and that this fiscal package has to be carefully communicated across the political and civil society spectrum and implemented with transparency. Implementing the expected fiscal adjustment in a sustainable way will be instrumental to maintaining the strong financial support of bilateral and multilateral donors.

Mr. Panek made the following statement:

The success of the strategy in the Central African Economic and Monetary Community (CEMAC) region hinges crucially on the steadfast implementation of sound policies and structural reforms at the national level. We recognize that progress has been made in the CEMAC region as a whole. However, Gabon's performance under its Fund-supported program has fallen short of its objectives on many counts, attesting to a lack of adequate ownership. In particular, performance criteria were repeatedly not met, and deviations were large. It is important to keep in mind that program conditionality plays a key role in mitigating credit risks, and thus, in safeguarding the Fund's resources.

We take note of the corrective measures but remain to be convinced that this will be sufficient to reach program objectives in a timely manner. Our considerations are laid out more extensively in our gray statement. Based on this, we are not in a position to support the completion of this review and would like to be recorded as abstaining from the proposed decision.

I would also like to share with the Board some concerns about evenhandedness. We are aware of program reviews that the staff and management would not have brought to the Board if the type of program performance that we are discussing today had been shown. Instead, the staff and the management would surely have insisted that the authorities meet most, if not all, quantitative conditionality. We call on the staff and the management to ensure that all members of the Fund are treated in an evenhanded manner.

Ms. Pollard made the following statement:

We thank the staff for their work on this fragile state. Gabon's program performance since the last review has been weak, with several missed performance criteria and indicative targets, as well as a slow pace of implementation of structural benchmarks. Even at the time of the program's approval, the authorities' planned fiscal and structural reform agenda seemed aspirational. Delays only make adjustment more difficult, as additional effort will be needed to make up for slippages. The accumulation of new external arrears after the December commitment to clear all arrears by end-2017, suggests a lack of program ownership earlier this year. We share the concerns raised by Mr. Saito and Mr. Ozaki, that the delayed implementation of several key structural measures will not help prevent the accumulation of new arrears. Moreover, we are particularly concerned about the missed performance criterion on the primary non-oil balance, which is indicative of the authorities' policy efforts, and the missed targets on social protection spending and non-oil tax revenue. For these reasons, our chair has abstained on this decision.

We welcome the authorities' efforts as of May to get the program back on track, including the passage of the 2018 supplementary budget, the establishment of an economic task force, the completion of five notable prior actions, and efforts to clear all external arrears to official creditors prior to this Board meeting.

We appreciate the confirmation in Mr. Sembene's buff statement that the authorities remain strongly committed to the program and intend to speed up reform momentum. We sincerely hope that this progress continues so that we can support Gabon's next program review and, most importantly, so that the authorities can strengthen macroeconomic stability, foster diversified economic growth and job creation, and improve social protection.

Turning to a broader regional issue, we agree with Mr. Gonzalez that the CEMAC country programs could benefit from a degree of exchange rate flexibility and we look forward to the staff's answers on the questions he raised.

Finally, in terms of process, we echo Mr. Merk's and Mr. Maluck's comment that the breach of the minimum circulation period is regrettable, given the many complicated aspects of this program review.

Mr. Merk made the following statement:

We thank the staff for the candid report and the frank assessment, and Mr. Sembene, Mr. Razafindramanana, and Mr. Nguema-Affane for the informative buff statement.

Program performance at end-December 2017 and through end-June 2018 has been particularly disappointing in the context of the special situation in the CEMAC. Almost all CEMAC member countries have a Fund-supported adjustment program in place, and policy assurances have been provided by regional institutions. However, program success, first and foremost, relies on strong adjustments in the respective member countries, and fiscal slippages directly increase the burden on other countries and the regional institutions.

Nevertheless, considering the positive corrective measures, including six prior actions, we are prepared to reluctantly consent to the completion of the review. We highlight the urgent need for the authorities to strengthen program ownership. A clear demonstration of much-improved program implementation should be made a precondition for presenting the next review to the Board.

Lastly, we urge the authorities to accelerate the process of clearing all external arrears.

Mr. Saito made the following statement:

We thank the staff for the informative papers and Mr. Sembene and his colleagues for their insightful statement.

It is encouraging that the macroeconomic conditions in Gabon have begun to improve gradually. The authorities' efforts to attract investment in new sectors could contribute to the diversification and resilience of the economy. However, we have serious concerns that program performance since December 2017 has been weak, with significant delays and slippages. In particular, we concur with Mr. Claver-Carone and Ms. Pollard that the accumulation of new external arrears is particularly troubling and suggests substantial risks in multiple areas of program implementation. In this context, we would like to offer two additional comments.

First, on external arrears, we are concerned about the failure to meet the commitment to clear all external arrears by the end of last year. The staff responded to our question, mentioning that at the time of the first review, the staff was not aware of the underlying spending pressures and the liquidity constraints generated by fiscal slippages. We wonder why the staff was confident at the time that all external arrears would be cleared by the end of December without knowing the critical fiscal situation, including the underlying spending pressures and liquidity constraints. We are not quite sure what happened in the last 10 days of last year after the Board meeting on December 21. We urge the staff to communicate closely with the relevant authorities to capture the fiscal and liquidity conditions accurately and in a timely fashion.

Second, on the capacity to repay, in response to our question, the staff mentioned that they believe that Gabon's capacity to meet potential repayment obligations to the Fund remains adequate. However, like Mr. Gonzalez, we believe the track record of the program's implementation is disappointing, so we are not fully convinced that Gabon's capacity to repay is adequate.

Having said that, we welcome that the authorities have cleared all external arrears to official bilateral creditors, as well as the multilateral and guaranteed claims of commercial creditors in July. We also positively note that the authorities have implemented all prior actions. That shows strong commitment to the success of the program. Against this background, we can hesitantly go along with the completion of the second review and the revised proposed decisions.

Finally, as Mr. Merk mentioned in his gray statement, a clear demonstration of much improved program implementation should remain a precondition for presenting the next review to the Board. Without demonstrating substantially improved performance, it would be difficult for us to go along with the completion of the next review.

Mr. Rouai noted that the indicative target on the floor on social protection spending had been missed throughout 2017 and that no data were available for the first six months of 2018. In view of the importance of social protection for the Gabon program, he suggested that the staff discuss with the authorities the option of transforming the indicative target into a performance criterion.

Mr. de Villeroché made the following statement:

I thank the staff for the report. It is quite a candid assessment. Like many, we regret the fiscal slippages and the accumulation of new arrears, which occurred during the first half of the year. This is concerning; and more broadly, it is concerning for Gabon and for the CEMAC region as well.

The composition of the adjustment is below what was expected when the program was approved. Targets on social protection spending and non-oil tax revenue were missed. We see these targets as being critical to ensure that the fiscal consolidation is sustainable in a context in which the poverty rate remains high, even if Gabon has some important commodities and resources.

Having said that, we also take into consideration the fiscal package that was decided in June. We believe it is an opportunity to restore the program's credibility, and we welcome the task force in charge of program supervision, which was recently set up at the highest level of the state.

On the revenue side, streamlining the exemptions and phasing out the expensive customs procedures are relevant objectives that are able to create quick wins. On the expenditure side, we see the elimination of ghost workers and the reduction of administrative agencies as important measures which are very welcome.

Gabon needs to prove now that this plan will be implemented. I do not accept the idea that there is an evenhandedness issue since we have measures to restore the situation, but it is clear that Gabon now needs a strong implementation record for the next review. We support the completion of this review.

I would like to make one more remark on the macro economy. When we see where they are starting and where they are coming from, there is still the public debt, but it is declining. The overall public deficit is declining as well. The situation is concerning regarding the implementation of the program, but there has been an improvement, and there is an ongoing adjustment. We need to be fair and acknowledge that as well.

Mr. Just made the following statement:

It would not have taken much, and this review would have had to be postponed.

We are one year into the program but have only now cleared the external arrears hurdle. Getting to this point has drained Gabon's much needed liquidity and has focused too much of the authorities' attention. We hope that the external arrears will be relegated to history in Gabon and that the administration will finally start respecting contracts and strive to remain in good standing with the private sector, no matter whether a company is external or domestic.

Re-establishing the trust that has been lost over the years due to the nonchalance and callousness of the authorities will take time. Chronic arrears are a symptom of severe deficiencies in public financial management. The mission team, together with the Fiscal Affairs Department, have done an incredible job of trying to tackle the root causes and come up with some solutions that hopefully will deliver results.

It is a Herculean task, but the Fund can only do so much, and we cannot expect the staff to identify and repair all of the many leaks in the systems. Ultimately, the authorities should have a strong interest in a well-functioning public administration, and we urge the authorities to combat in earnest the extensive graft in Gabon. Transparency at all layers of government will be necessary.

We appreciate that the staff is trying to make the social spending targets more meaningful. Headline figures are convenient but can give us false comfort. One positive aspect of the staff's approach to social spending in the case of Gabon is the close cooperation with the World Bank, so that the staff targets the right programs and categories of social spending.

On health, we are concerned about the provision of even basic health services for the population. The company that managed and serviced three-quarters of Gabon's hospitals had to pull out in early June. By now, two of the hospitals had to close for good.

To conclude, we share the substantial unease expressed by several Directors about whether the authorities are actually committed and willing to implement the Fund-supported program. The staff has made tremendous efforts to bring the program back on track. It is now up to the authorities. We give the authorities the benefit of the doubt and go along with the proposed decision, although reluctantly.

Mr. Hurtado made the following statement:

We can go along with the review and the decisions, but we would like to make a few points.

First, we believe that the program is overambitious, especially on the fiscal side. That is also a cause for concern about the arrears, as has been mentioned. We also agree with the problems of evenhandedness in the case of Gabon, as Mr. Panek put it. But I would like to make a more general point that has to do with the rigidity of the exchange rate regimes that this economy is facing.

Our chair has insisted that at some point the staff should examine the possibility and the effects of having a more flexible exchange rate. This point goes well beyond Gabon and well beyond the work of the team, but it is a repeated problem for the terms of trade for the CEMAC and West African Economic and Monetary Union (WAEMU) countries. In our view, the rigidity of the exchange rate greatly complicates the problems.

The staff responded that there is a problem with inflation: that if the exchange rate is more flexible, there may be problems with inflation; and that the economies are not well diversified. But there are supply-and-demand responses to a more flexible exchange rate. It is not only the supply. It is time for the staff to do what we asked in our gray statement, and we expect an answer from the staff, a serious assessment of the costs and benefits of having a more flexible exchange rate. We know that this is a country's autonomous decision, but the Fund often makes recommendations that are not liked by the authorities. That has been the case in many countries. This is something that is due.

Mr. De Lannoy reluctantly supported the completion of the review. He supported Mr. Panek's comments on treating Fund-supported programs in an evenhanded manner. He joined Mr. Merk in stressing the need for substantially better program performance before the next review should be brought to the Board.

Mr. Palei made the following statement:

In our gray statement, we also expressed concerns about the authorities' weak performance; but on balance, we relied on the staff's judgment that the authorities deserve consideration for their current performance in the completion of the review. Consequently, we did support the completion of this review.

At the same time, we agree that the large number of prior actions—six in total—points to the lack of ownership and generally is a worrying sign.

We are also concerned about evenhandedness. Several Directors mentioned evenhandedness, and it looks like the current modalities of addressing these concerns do not work well. Recently, we had a discussion on the upcoming review of conditionality, and the staff referred to the fact that no Director formally asked for consideration of evenhandedness. We have this formal mechanism where a Director can simply write an email and ask for a special investigation or consideration of that particular case, but hardly anybody does it. During our discussion of the upcoming review, the staff mentioned another indicator that referred to the number of times evenhandedness was mentioned by Directors during Board meetings and also in their gray statements. In this case, Directors have expressed concerns about evenhandedness, and I am not sure how this issue will be handled further. Maybe the staff could explain what happens after all of these concerns are raised at the Board and what would be the reaction of the Strategy, Policy, and Review Department (SPR) and the country team in this particular case.

Mr. Leipold made the following statement:

Like other Directors, including the co-signatory of our joint gray statement, Mr. De Lannoy, we note our hesitation to give the benefit of the doubt at this stage, given Gabon's feeble track record. In doing so, I do not think we are being particularly un-evenhanded, but that is sometimes in the eye of the beholder, which we can discuss in a broader context.

With regard to Gabon, we only hope that the ambitious supplementary budget adopted at end-June really marks a turning point. That is what brought us to the decision to support the review, so that the track record at the time of the next review will be markedly different and provide the necessary reassurance regarding ownership and commitment that everybody has mentioned. Our position will hinge on this.

The staff representative from the African Department (Mr. Segura-Ubiergo), in response to questions and comments from Executive Directors, made the following statement:[1]

I would like to address four questions that were not part of the staff's written responses to technical questions raised in the gray statements.

The first is delays that were associated with the completion of this review, including this new question about what happened in December. The second is the nature and the feasibility of the corrective measures, the package that is being presented, why we believe it is a solid package. The third is the question of competitiveness in the exchange rate regime that has been mentioned; and finally the issue of social protection, which has also been an issue for discussion.

This has been a difficult review. We had to conduct two staff visits and a review mission in July. We initially had planned for a review in June. In part, the difficulty was associated with the complexity of the case. As has

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

been mentioned, some objectives of the program are working according to plan. Public debt has stabilized and is beginning to decline; that was one of the core initial objectives of the program. The current account is also adjusting; it was another objective of the program, and that is being achieved.

One of the key indicators, the overall fiscal deficit, has adjusted by 3 percent of GDP. One could argue that fiscal policy is improving. However, when we look closely at the performance with a much more in-depth assessment, we realize that part of this adjustment was simply because oil prices were increasing, so the authorities were collecting more oil revenues. Yet non-oil revenues were declining and spending pressures on key items—like the wage bill, which we had emphasized before was a critical component of the program—those issues were not being tackled.

At the end of December, the authorities had cleared all of the official arrears prior to the Board meeting. They committed to the clearance of all the other external arrears, and they provided to us the confirmation in writing. That commitment was both in the memorandum of economic and financial policies (MEFP), but they also sent us a letter prior to the Board meeting, explaining that the commitment would be implemented.

In the Gabon system—it is part of the francophone system—expenditure orders can be executed sometimes up until the end of the year, and the payments for the execution of the budget sometimes occur up to the month of February.

At the end of December, the authorities had enough liquidity to clear all these external arrears, but we came to the conclusion that there were underlying spending pressures on a number of items that we were not aware of in November and in December, that led to the slippages they are now documenting in the report, including the reasons why they missed the quantitative performance criteria in December. It was impossible for us to anticipate that at the time.

There is a lag of about two months—sometimes even more—in the production of fiscal statistics. By the end of the year, they did have enough liquidity to have cleared the arrears, but there was also an issue of coordination between the authorities and different priorities. They decided in the end not to do that. Not only that, but they also accumulated arrears in the first part of the year. That is why we tried to be candid in the report, explaining why that is a serious issue.

Having said that, we also feel that the package that is being presented is very strong. It is not just a package based on commitments; it is based on actions that we have already seen. I will mention a few of the most important ones.

The first problem was the collection of non-oil revenues. We noticed that there was a significant problem at customs, extensive exemptions that were leading to a loss of revenues but also were creating leakages and problems of customs administration, including inefficiencies. That program has been completely eliminated. It is similar to an elimination of subsidies, which is politically sensitive in any country, and the authorities have already done it. They have announced in public this measure, which has two important effects. First, they immediately collect more revenues. But second, it eliminates problems of fraud because there were 200 items on that list, and now there are just a few items that one could argue are more closely related to the consumption basket of the poor: milk, bread, and other small items. That is the key measure.

The second measure concerns the wage bill. On the wage bill, I am not sure we can argue that the fact that there are all these prior actions means there is a lack of ownership because, in fact, the authorities went beyond some of the recommendations that the staff provided. The case of the wage bill is particularly telling. The authorities have introduced reform measures that lead to savings on the wage bill of 1 percent of GDP beyond what the staff had proposed. Those have already been implemented. We know they have been implemented. They were announced as part of the supplementary budget, and they have become implemented. I will mention just one which I believe is critical. It is a measure that requires public servants to obtain physical presence tests. Each civil servant needs to certify that he or she is showing up for work before collecting a paycheck. That has allowed the authorities to identify 6,000 employees that should not have been in the payroll. That is a measure that is difficult to implement. There were protests about it. I believe it was quite courageous for the authorities to do that two months before an election.

The third measure that we felt was very strong, which was another source of problems in the fiscal area, was the spending by decentralized government units, agencies. The authorities announced that they would close about 100 agencies and reintegrate these autonomous agencies within their ministries. This issue was creating two problems. It was creating spending pressures, but also inefficiencies because these agencies are not subject to the same level of controls. That is also a measure that is already being rolled out.

I could mention other measures, but these are the key measures of the authorities' adjustment package.

On social protection, the large fiscal adjustment is a concern. We have insisted that vulnerable groups need to be protected from the burden of this adjustment. Part of the problem we observed in 2017 was associated with the fact that there was under-spending on investment in the education sector. The authorities were going to build some educational facilities; but some of these investments were also associated with counterpart funding from external partners. Those funds did not come precisely because of the problem of external arrears. The authorities have tried to do three things.

The first is to identify new programs that should be subject to protection with the help of the World Bank. These programs have already been included in the supplementary budget. There is, for example, a new program that provides free birth services to mothers.

The second is they have increased the envelope. The envelope for social spending was 1 percent of GDP in 2017. Now they have increased it to 2.3 percent of GDP. But placing these allocations in the budget is not enough. One needs to monitor the actual implementation of the programs. The additional reforms included measures to improve targeting, to ensure that the spending goes to the right people. The World Bank is negotiating with the authorities and paying particular attention to this issue. The World Bank is also ensuring that when there are budget pressures during the execution of the budget in the year, the authorities do not deviate from spending lines, move something that has been reserved for social spending to another budget line. The commitment in the MEFP in the supplementary budget is to avoid these changes in allocations in budget lines.

We rely largely on the expertise of the World Bank on this issue. We tried to support it with an indicative target. It would be difficult to transform the indicative target into a quantitative performance criterion for issues of monitorability. But we believe that with the indicative target, the authorities understand well what they need to do. They probably need technical assistance. Gabon is a middle-income country that does not usually receive a significant amount of technical assistance (TA), so providing TA to identify exactly what are the programs, how they should be tracked, should also be part of the solution.

Regarding the question of competitiveness and the exchange rate, I am not in a position to comment more generally on the exchange rate arrangement. This is a debate for the regional paper. As my colleagues discussed, this was a choice made by the authorities to maintain the current arrangement and then introduce a coordinated response.

What I can say is that the exchange rate arrangement is providing some incentives for investors to continue to invest in an environment of stability. Gabon is one of the few countries in CEMAC that is managing to introduce successful diversification policies. We mentioned in the technical responses how FDI has doubled from 4 percent of GDP to 9 percent of GDP. That is equivalent to US$1.5 billion per year. That is a massive investment that helps Gabon diversify away from oil—for example, Gabon is likely to become the largest producer of manganese in the world, and it is also into agribusiness—particularly in sectors that can also produce exports and help with the current account adjustment.

What else can be done in addition to fiscal policy? Fiscal policy is a critical component of the adjustment, and to the extent that that is done through the wage bill, that can also help with the contribution of fiscal policy to the competitiveness of the economy.

The authorities are also targeting reforms in the business sector. They have a special economic zone that is attracting investment, but they are also trying to introduce broader reforms that go beyond just the targeted sectors.

The staff representative from the Strategy, Policy, and Review Department (Ms. Sun), in response to questions and comments from Executive Directors, made the following statement:

I would like to address two issues. One is on the regional policy assurances, and the other touches upon evenhandedness.

On the regional policy assurance, the completion of the third review for Gabon would be conditional on the implementation of the three regional policy assurances. This is laid out in paragraph 31 of the staff report and also paragraph 45 of the staff appraisal.

The approach we take in the case of Gabon follows other recent CEMAC program reviews, such as Cameroon and Chad, where regional policy assurances are documented in individual program review staff reports, as well as in the Summing Up of the Board meeting. Furthermore, the letter containing the three policy assurances critical to the success of individual Fund programs, such as Gabon, has already been published in July 2018 as part of the publication of the CEMAC region-wide background paper.

On the issue of evenhandedness, on numerous occasions, the Board has recognized there is an inherent tension between evenhandedness and tailoring. Tailoring is one principle of the conditionality guidelines. Programs deal with unique situations that require a tailored approach.

In the case of Gabon, there are significant fiscal slippages, and the staff recommended a completion of the second review based on the strong corrective measures taken.

On that account, I can compare the measures to the average and provide an example of the number of prior actions. As Directors may recall from last week's presentation on the Review of Conditionality, the average of prior actions per completed review for commodity-producing countries is one-half. In the case of Gabon, because of the significant slippage, we have required stronger prior actions. There are six prior actions in this case. If one looks at the quality of the prior actions, many of them fall into this category we call "high-depth prior actions," meaning they are more durable, more significant, and have more intensity. For example, if one sees the supplemental budget, the prior action is the adoption by parliament of the supplemental budget, rather than a comparable "low-depth prior action," which would be the submission of the budget to the parliament. In addition, one prior action was the elimination of customs tax exemptions.

In this case, the staff recommended a completion of the review based on strong corrective measures in light of the significant slippage.

Mr. Razafindramanana made the following concluding statement:

I thank Directors, management, and the staff for their support for the completion of the second review of Gabon's Fund-supported program under the Extended Fund Facility (EFF). I thank the mission chief, Mr. Segura-Ubiergo, and his team for their relentless efforts and constructive policy dialogue with the authorities. As Mr. Segura-Ubiergo leaves the Gabon team to lead the Congo team, I would like to convey the Gabonese authorities' sincere appreciation for Mr. Segura's work on Gabon.

I took note of Directors' comments and recommendations, which will be faithfully conveyed to the authorities. In particular, I welcome Directors' acknowledgement of the authorities' strong policy adjustment package taken a few weeks ago to keep the program on track. This includes the adoption of the supplemental budget and the strong prior actions, which signal their continued ownership of the program, including politically sensitive measures. As we indicated in the buff statement, the authorities remain strongly committed to the program and intend to speed up reform momentum to strengthen macroeconomic stability and foster economic diversification while further contributing to regional external stability.

Directors highlighted the risk to the success of the program stemming from potential delays in program implementation. In this connection, it is noteworthy that steps are underway to further improve program monitoring and coordination between public agencies, with a view to ensuring that program objectives are met in a timely manner. In the same vein, they will continue their outreach efforts and dialogue with different stakeholders to strengthen the public's support of the program.

The authorities also agree with Directors on the importance of pursuing the fiscal consolidation and strengthening fiscal discipline to improve fiscal and debt sustainability. They concur with Directors on the need to accelerate structural fiscal reforms to boost domestic revenues, contain expenditures, and to avoid the accumulation of new arrears. To this end, they will further advance reforms of tax and customs administration and strengthen efforts to improve public financial management, and the efficiency of public investment will be accelerated.

Equally important is the need to strengthen social safety nets and preserve social spending, as recommended by many Directors. Adjustment efforts and cash flow tensions contributed to the non-observance of a related benchmark, which is not reflective of the high priority accorded by the authorities to social protection.

Going forward, the authorities are determined to make further progress on these important elements of the program. In this regard, several initiatives have been launched to better target the most vulnerable segments of the population, especially women. The assistance of the World Bank in the identification and monitoring of key social spending will help improve their performance on that front.

Continued and timely support from the Fund and other donors will be crucial in achieving their goals. The authorities will continue their efforts to settle domestic debt arrears, as scheduled. This is critical to support economic activity and mitigate risks to financial stability, particularly those stemming from rising NPLs. Following the rescheduling and clearance of external debt arrears to bilateral and multilateral creditors, the authorities are committed to making similar inroads with regard to arrears owed to commercial creditors.

With regard to the three distressed public banks, the authorities will pursue efforts to resolve them in collaboration with the regional banking commission, the Central African Banking Commission, bearing in mind the need to minimize the costs and to limit the impact on financial inclusion, given the limited presence of banks in some rural areas.

Sustaining strong reform implementation will also be important to enable sustained and inclusive medium-term growth. In that respect, our authorities are building on the successful diversification efforts to date to make further strides in the implementation of their reform agenda aimed at improving the business climate and further attracting new investment, notably in sectors that promise high growth, such as mining and agriculture.

To conclude, I reiterate that the authorities remain strongly committed to the program objectives. The Fund’s support, especially in the context of capacity building, will remain critical in that regard.

Once again, I thank Directors for their support to the completion of the second EFF review.

The Acting Chair (Mr. Lipton) encouraged Mr. Razafindramanana to convey to the authorities the Board’s support for the program, but also the weight of the concerns expressed by Directors and their reluctance to complete the review. He encouraged Mr. Razafindramanana to emphasize that sufficient ownership and action would be needed to sustain the support of the Board.

The following summing up was issued:

Executive Directors noted that slowly improving macroeconomic conditions in Gabon are helping to bolster economic diversification and resilience. They regretted, however, that weak program performance since the completion of the first review in December 2017 poses risks to the fragile recovery, given serious fiscal slippages, continued arrears accumulation, slow progress in the implementation of key structural reforms, and low social spending. Directors underscored the critical importance of addressing these issues by strengthening reform ownership and implementation to improve the authorities’ track record under the EFF arrangement.

Directors welcomed the authorities' resolve to strengthen fiscal discipline and reinvigorate reform efforts. They saw merit in the corrective actions that aim to bring fiscal consolidation back on track, including the 2018 supplementary budget, as well as specific steps taken to contain the wage bill and improve the monitoring of social spending. At the same time, Directors emphasized the political and social challenges of implementing such measures, and urged the authorities to build public support through a robust consultation and communication strategy and by protecting key social spending.

Directors were encouraged by the authorities' initiatives to improve fiscal risk management and called for additional efforts to step up coordination among key ministries to avoid fiscal slippages and delays in reform implementation. They noted that the new system of automatic spending adjustments, in the event that non-oil revenue underperforms, would safeguard fiscal discipline and mitigate the risk of new arrears. Directors called for a timely clearance of remaining domestic arrears in line with the agreed calendar under the Club de Libreville.

Directors stressed the importance of progress on the structural agenda to increase the efficiency and transparency of public finances. They saw scope for enhanced revenue mobilization as well as streamlining of tax exemptions to support the revenue base. Directors also urged the authorities to better track expenditures and complete the audit of possible extrabudgetary operations to strengthen their ability to meet their fiscal targets. More generally, measures to improve the business environment, bolster competitiveness, and diversify the economy were encouraged.

Directors noted that the financial sector remains broadly sound, but the rise in non-performing loans (NPLs) poses a continuing vulnerability warranting further efforts to strengthen the legal and supervisory framework for NPLs. While the three public banks in distress are relatively small and do not pose systemic risks, Directors urged a timely resolution of their situation to limit the eventual costs to the budget.

Directors noted that Gabon's program is supported by the implementation of policies and reforms by the regional institutions, which are critical to the program's success. These comprise the implementation of the three policy assurances provided in the June 2018 Letter of Policy Support and the union-wide background paper. Completion of the third review will continue to be conditional on the implementation of these policy assurances.

The Executive Board took the following decision on August 1, 2018, with two abstentions by Ms. Pollard (US) and Mr. Panek (SZ):

Gabon—Second Review of the Extended Arrangement Under the Extended Fund Facility, Requests for Waivers of Nonobservance of Performance Criteria and Waivers of Applicability, and Financing Assurances Review

1. Gabon has consulted with the Fund in accordance with paragraph 3(c) of the Extended Arrangement under the Extended Fund Facility for Gabon (EBS/17/52, 06/06/2017) (the "Arrangement") in order to review program implementation.

2. The letter dated July 24, 2018 from the Minister of Economy, Prospective and Development Planning (the "July 2018 Letter"), together with its attached Memorandum of Economic and Financial Policies (the "July 2018 MEFP") and its Technical Memorandum of Understanding (the "July 2018 TMU") shall be attached to the Arrangement, and the letter dated June 5, 2017 from the Minister of Economy, Prospective and Development Planning, together with all of its attachments and as subsequently supplemented and modified, shall be read as further supplemented and modified by the July 2018 Letter and its attachments.

3. Accordingly, the Arrangement for Gabon shall be amended as follows:

   a. Paragraph 3(a)(iv) of the Arrangement shall be amended by inserting "; or" at the end of the paragraph;

   b. A new paragraph 3(a)(v) of the Arrangement shall be inserted as follows: "(v) the cumulative floor on central government tax revenue, excluding oil revenue."

   c. The targets for December 31, 2018 for the performance criteria set forth in paragraphs 3(a)(i) through 3(a)(v) of the Arrangement shall be as specified in Table 2 of the July 2018 MEFP and further specified in the July 2018 TMU.

   d. The continuous performance criteria set forth in paragraph 3(b)(i) of the Arrangement shall be as specified in Table 2 of the July 2018 MEFP and further specified in the July 2018 TMU.

4. The Fund decides that the financing assurances review specified in paragraph 3(e) of the Arrangement and that the second review specified in paragraph 3(c) of the Arrangement for Gabon are completed, and that Gabon may make purchases under the Arrangement up to a cumulative amount of SDR 214.29 million until August 15, 2018 and thereafter in accordance with the provisions of the Arrangement, notwithstanding: (i) the unavailability of information necessary to assess the observance of the end-June 2018 performance criteria specified in paragraphs 3(a)(ii) and (iv) of the Arrangement, on the condition that Gabon has accurately represented that such information is unavailable, and the information provided by Gabon on the performance under the criteria specified in paragraphs 3(a)(ii) and (iv) of the Arrangement as of end-December 2017 is accurate; (ii) the nonobservance of the June 30, 2018 performance criteria on the floor on the primary fiscal balance specified in paragraph 3(a)(i) of the Arrangement and the ceiling on central bank net claims on the central government specified in paragraph 3(a)(iii) of the Arrangement, and the continuous performance criterion on the ceiling on the accumulation of new external payment arrears by the central government specified in paragraph 3(b)(i) of the Arrangement, on the condition that the information provided by Gabon on performance under these criteria is accurate; and (iii) on the further condition that the information provided by Gabon on the implementation of the measures specified as prior actions in Table 4 of the July 2018 MEFP is accurate. (EBS/18/72, Supplement 1, 7/31/18).

Decision No. 16423-(18/74), adopted
August 1, 2018

APPROVAL: March 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***We wonder if such a program can realistically be successful even if it contains necessary measures to improve public financial management and safeguard the stability of the financial sector. Could staff comment on the reasons why there were delays in the completion of the report and if they were related to reaching an agreement with authorities? Why was not a detailed explanation of the authorities' position included in in the report? Along the same lines, what is the position of donors and other stakeholders in the international community regarding the progress of the current program and the need for further adjustment? Are there any changes in their commitments and/or requirements to support the current program?***

- Staff will respond to this question during the Board meeting.

2. ***We positively note the strong policy package aimed at an adjustment equivalent to 3.1 percent of GDP in the overall fiscal deficit (cash basis) in 2018. However, we are not fully convinced about the ability to achieve this stronger adjustment target given the developments thus far in 2018 and the fragile conditions, including social tensions. Could staff comment?***

- Staff will respond to this question during the Board meeting.

3. ***We note that the program envisages a reduction of the overall fiscal deficit of 3.1 percent of GDP in 2018 on top of similar reduction observed in 2017. This may be an ambitious target, given still weak implementation capacity and fragility of social and economic situation. We would welcome staff comments on the feasibility of the fiscal consolidation target and possible risks in this area.***

- Staff will respond to this question during the Board meeting.

4. ***FDI has been flowing into sectors other than from oil, and is expected to remain favorable in the medium term. How is the FDI outlook compatible with a modest output growth projection combined with the need to foster essential structural reforms? Staff's comments are welcome.***

- Direct investment into Gabon has roughly doubled from around 4.5 percent of GDP per year over 2010-14 to 9 percent during 2015-17, and is expected to remain at that level through 2019. This trend is due to large outlays in agribusiness, mining, and related infrastructure in the special economic zone (SEZ). Such investments target mostly exports for international and regional markets and, therefore, are somewhat independent from the country's own outlook.
- Regarding the impact of FDI on Gabon`s outlook, although the projects are advanced, they tend to have long startup periods—for example, agricultural production will ramp up gradually as fields mature over the next five years—which is a factor explaining the modest output projection.

Program Issues

5. ***We still think that the Fund should assess explicitly costs and benefits of moving to a more flexible ER regime and if it would allow for a better calibration of the policy package and for building new lines of defense should the current approach continue to be so difficult to implement. Could staff provide this analysis? Additionally, beyond fiscal policy, what other adjustments in the policy would be advisable to manage the reported risks and increase the possibility of success?***

- Staff will respond to this question during the Board meeting.

6. ***The success of this program depends on the implementation of supportive policies and reforms by regional institutions. We agree that the three regional policy assurances are critical to the success of the program, and that the completion of the third review be conditional on the implementation of these measures. However, we wonder if this region-level conditionality should be formally recorded alongside the program documents, rather than appearing only in the staff appraisal. The summing up of the program design in currency unions discussion says that assurances from currency union institutions "will be part of the program documentation, and published following a similar approach to the one that applies to the publication of policy intention documents from the national authorities". Staff comments are welcome.***

- Staff will respond to this question during the Board meeting.

7. ***A clear demonstration of much improved program implementation should be made the precondition for presenting the next review to the board. In this respect, we wonder which criteria would be the basis for the third review, since end-June 2018 PCs have already been part of this review. Staff comments are welcome.***

- If the 3rd review under the extended arrangement for Gabon takes place before end-December 2018, end-June 2018 performance criteria will remain controlling. As such, performance can be assessed based on the two end-June 2018 PCs for which data is not yet available but also no evidence/indication that they may have been missed. These two performance criteria (external debt ceiling and net claims of the banking system on the central government) are strongly related to the fiscal performance criteria (for which the authorities have requested a waiver of non-observance for end-June 2018 based on estimated data).

- More generally and from a policy perspective, in coming to a future decision to recommend completion of the 3rd review, staff will consider Gabon's past performance (including end-September 2018 ITs) and policy understandings reached in the future. In staff's view, assessment of end-September ITs would need to demonstrate that the implementation of the corrective actions has been effective.

Fiscal Policy

8. ***Staff comments on how much the World Bank's technical assistance on public sector wage bill in December 2016 benefited the recent wage bill reduction measures are welcome.***

- The WB's technical assistance provided recommendations to develop performance-based pay and bonuses, which will help implement the reduction of bonuses, one the main component of the wage bill reduction.

9. ***Long-standing and deeply entrenched weaknesses in public financial management must be addressed more forcefully. We note with regret that progress on structural fiscal reforms to date has been limited. Could staff elaborate on possible capacity constraints in this regard? We emphasize that deep and sustained measures remain necessary to significantly improve public financial management. The staff report lists reforms on many fronts. Could staff elaborate on the appropriate sequencing for the introduction of the proposed fiscal structural measures?***

- Immediate structural reforms need to be focus on the core functions of the PFM system, including improving expenditure controls, but also cash management and fiscal reporting. As a second step, the authorities should prioritize (i) strengthening institutional arrangements for the oversight of public entities; (ii) enhancing planning and monitoring of public investment projects; and (iii) broadening coverage of the budget.

- Strengthening expenditure controls also depends on efforts to upgrade of IT systems, which had so far been limited by technical constraints and the need to adequately train staff. At the same time, technical assistance was provided to strengthen capacities on fiscal reporting, arrears monitoring and cash management.

10. We welcome the measures announced in June to rein in public wages, improve customs tax collection, and better track expenditures through the E-BOP system – all of which will provide the basis for more sustainable, transparent, and growth-friendly fiscal policy going forward. We notice that the structural benchmarks for 2018 (MEFP Table 4) do not include any follow-up measures in these three areas. Could staff comment on how the program will monitor the authorities' ongoing efforts and promote further reform implementation in each area? Could staff provide more insight on whether the level of coordination between the Ministry of Economy and Budget Ministry is sufficient to align revenue collection and expenditure execution in support of a cohesive overall fiscal strategy?

- Wage bill reform, customs revenue mobilization, and strengthened expenditure controls are expected to have a direct impact on fiscal outturns. The measures aim to reduce the wage bill, increase non-oil revenue, and contain expenditure arrears.

- The wage bill reform also includes structural measures, notably the implementation of performance-based pay or retirement plans. To continue increasing customs tax collection, the authorities agreed to introduce new reforms, including measures to strengthen customs audits and improve the effectiveness of customs procedures. As a follow up measure to the upgrade of the VECTIS and E-BOP systems, an upgrade of financial information systems will also be rolled out to public entities, notably semi-autonomous government entities (special accounts), which are often outside the regular budget process. This will ensure the enforcement of more rigorous expenditure controls beyond the central government.

- New regulations have been introduced to coordinate work and data-sharing on macro-fiscal issues across government departments and, especially, between the Budget and Economy Ministries. A specific committee has also been established to ensure adequate coordination between relevant departments of both Ministries.

- In addition, recent technical assistance has been provided to strengthen coordination and improve macro-fiscal forecasting. The regular issuance of quarterly reports on budget execution will also enhance data exchange, and facilitate joint monitoring of revenue collection and expenditure execution.

11. Given the disappointing trend in non-oil revenues in recent years, we wonder if the envisaged measures are well sequenced and sufficient to reverse the dynamics in line with the program expectations. We note that the observed underperformance of

non-oil revenues in 2017 was also explained by social tensions with the personnel in charge of the collection of tax and custom revenues. As the wage bill and bonuses reduction in "non-social" sectors are essential in the proposed public expenditure rationalization, could staff provide their prospects on this front going forward?

- Some of the recently announced wage bill measures are unrelated to the bonus reform, including measures that require monthly physical presence tests to address ghost workers (of *bonne de caisse*), and efforts to scale back the sizeable cabinets of public administrations.

- Regarding the bonus reform, structural weaknesses in the former bonus system were indeed a factor in the strikes by tax and customs officials. However, in parallel with the reduction of bonuses, the reform aims to improve the design and the implementation of performance-based pay. Clear communication on the new rules and criteria linking bonuses to staff collective and individual performance will help reduce social tensions on this issue.

12. We would welcome more details on what steps have been taken so far and which state-owned enterprises/properties are ready to be privatized to realize these privatization receipts.

- Staff estimates that CFAF 30 billion of the portfolio is composed of liquid assets that could be immediately divested. In addition, two exit operations are already planned to take place in October and in December, respectively CFAF 16 billion and CFAF 23 billion.

13. While 85 percent of the list of products benefiting from exemptions were eliminated, few pro-poor items in the list are still exempted and we wonder why they have not been approved by law. Staff elaborations are welcome.

- While the law approved by the Parliament establishes the principle of VAT exemptions, the specific list of targeted products is detailed by an order of the Economy Minister. This conforms to the legal precedent, introducing the changes to the list on the same legal basis, and allows for further modifications with a view to reducing these exemptions.

14. It will be important that new social protection programs are well designed, well-targeted, and transparent to direct scare resources to those most in need. For example, we note that the remaining customs exemptions are targeted towards select pro-poor items. Could staff discuss the progressivity of the remaining items

on the customs list and confirm that the exemption list has indeed been made public to ensure accountability?

- The exemption list targets items consumed by Gabonese lower-income households, including rice, milk, pasta, canned tomatoes, canned sardines, and some basic forms of chicken, pork and beef. The order of the Economy Minister, detailing this list, has been published.

Social Spending

15. The floor on social protection spending was missed all along 2017 and no data are being provided on the level at end-March 2018 or end-June 2018 (MEFP, Table 2). Could staff clarify why data on the indicative target for end-March 2018 are still missing?

- Since Q2 2018, the government has launched reforms to prioritize social spending, make its delivery more efficient (implementation of a performance-based financing (PBF) reforms), and improve quarterly reporting. Data for end-June budget execution are not yet available, and the IT outturn for end-March is being revised due to complex PFM and classification issues in the budget nomenclature to track spending at the program level (rather than by general category spending). The World Bank has also been reviewing those initiatives and their implementation as part of its Gabon's Development Policy Operation (DPO).

16. The non-meeting of the IT on flow on social protection spending by end-December 2017 is a concern and we emphasize the need for providing adequate resources for social spending to protect vulnerable people as well as to education, health and infrastructure development to support sustainable growth. Could staff comment on this?

- Staff will respond this question during the Board meeting.

17. In light of the socio-economic situation, with one-third of the country's population living below the poverty line, ensuring public support for the difficult adjustment program will be crucial for overall program success. In this context, we would welcome if staff could elaborate on current efforts to protect the most vulnerable groups.

- Staff will respond this question during the Board meeting.

18. Could staff also confirm our reading from MEFP, Table 2 that the indicative target will be transformed into a performance criterion in December 2018? If so, we welcome and support this change and the authorities' commitment to ensure better

outcome in 2018 although we are not sure that the projected floors are realistic as they represent almost four times the December 2017 floor.

- Given the importance of non-oil revenue mobilization for the authorities' fiscal strategy as well as overall program objectives, the non-oil revenue target is being elevated to a performance criterion for December 2018, as indicated in MEFP Table 2, footnote 8. Social spending will continue to be treated as an indicative target.

Debt- and Arrears-Related Issues

19. As arrears appear to have become a drag on economic growth, we encourage the authorities to quickly implement their arrears strategy while putting in place measures to avoid further accumulation of arrears. Could staff provide comments on the strength of the authorities' plan and the challenges involved to decisively bring down arrears and avoid their further accumulation.

- Staff considers that the authorities have initiated a set of decisive measures to prevent the recurrence of new problems with arrears accumulation. They have started to hold regular meetings to update their monthly cash flow plan of revenues, expenditures, loan disbursements, debt repayment schedules, and the remaining arrears clearance plan. This will help ensure there is no short-term liquidity shortfall and the risk of re-accumulation of arrears is addressed.

- Over time, the authorities have also committed to building a reasonable buffer into the cash-flow plan in anticipation of possible temporary financing shortfalls. Funds required to cover shortfalls will be proactively mobilized to manage liquidity pressures; for example, by issuing short-term T-bills (maturity of less than a year), so that the excessive reliance on cash balances will be reduced.

20. We note that measures aiming at improving cash management, and covered by related structural benchmarks, were delayed. This is concerning given the urgent priority placed on improving cash management in the first review. Could staff provide us with further details on the reasons for such a delay and on how the program will support the authorities in this area going forward?

- Delays occurred in the widening of the coverage of the Treasury Single Account (TSA), stemming from the need to make technical adjustments at BEAC and exchange of information with commercial banks. The closure and repatriation to the TSA of accounts opened at the publicly-owned state depository corporation will be the next decisive step to streamline cash management. Further technical assistance will also be provided in the coming months to improve cash management and its coordination with debt management.

21. Could staff provide more information and share their views on the Club de Libreville arrangement?

- The Club de Libreville is an instrument to operationalize the clearance (payment) of part of the current stock of domestic arrears. The Club is formed with representatives of the government, companies, and commercial banks. This group identifies the domestic companies that should be part of the payment plan according to three criteria: (i) the company has to be a small or medium enterprise (SME); (ii) the stock of arrears to the company has to be lower than FCFA 2bn (about $3.5 million); and (iii) priority is given to companies in key sectors like health and education. By having clear selection criteria, and being in line with the overall budget envelope (see answers below), this instrument is consistent with the program's macroeconomic framework and arrears clearance strategy.

22. We welcome the use of Club de Libreville payment plan to settle a large share of domestic arrears (of about 5 percent of GDP) to SMEs over next six years. Could staff comment on the impact of this plan on the cash flow and the overall budgetary process?

- The implementation of the Club de Libreville payment plan helps reduce immediate cash flow pressure by spreading payments over the next six years (while still providing some relief to SMEs facing constrained liquidity), and therefore facilitates budget execution and expenditure payments.

23. When it comes to domestic arrears, we positively take note that a new "Club de Libreville", a payment plan used in the past to clear domestic arrears, has been agreed in April 2018 to settle a large share of domestic arrears to small- and medium-sized enterprises over the next six years, according to the buff statement. In this connection, could staff share the view about the inconsistency with staff's responses to technical questions (No.18) at the first review in terms of the duration (i.e. The program assumes the clearing of domestic arrears over a four-year timeframe)?

- Fiscal slippages in 2017 aggravated already significant cashflow pressures. This has contributed to delays in the clearance of domestic arrears relative to the plan outlined in the staff report for the 1st review. The recent fiscal measures should bring the fiscal consolidation back to the path agreed under the program and accelerate domestic arrears clearance per the schedule indicated in the present staff report.

24. Staff briefly mentioned several reasons in para 8 of the staff paper for the failure to meet the commitment under the Fund-supported program to clear all external

arrears at the end of 2017. However, these reasons seemed to be already predictable on December 20, 2017. Against this background, could staff elaborate more on the reasons of the failure to clear all the external arrears by the end of last year? Didn't staff recognize the reasons mentioned in para 8 at that time? Did the situation suddenly change after the first review board?

- At the time of the first-review Board, staff were not aware of the underlying spending pressures and liquidity constraints generated by fiscal slippages, including low revenue collection in the last quarter of 2017, which was mainly responsible for the failure to meet the program commitments on external arrears (the first reason noted in the staff report). The same factors also contributed to missing key QPCs at end-December 2017, as noted in the staff report.

25. We take note of staff judgement that the authorities are in "good faith" negotiations with all remaining commercial creditors, whose claims are not guaranteed, to clear the arrears by end-2018. Additional staff comments on these good faith efforts – including recent progress towards reaching a collaborative agreement with commercial creditors would be welcome.

- The authorities have shared relevant information regarding their financial difficulties with creditors to whom arrears are still owed and ascertained their commitment to clear the arrears by end-2018.

- In particular, the authorities have sent letters, which recognize upfront the arrears owed to each creditor. These letters have been shared with staff on a confidential basis. In addition, the authorities have already negotiated a debt reprofiling arrangement with one major creditor to whom (non-guaranteed) commercial arrears are owed and are in the process of similar engagements with the remaining creditors**.**

26. Could staff elaborate more on the adequacy of the capacity to repay, considering the recent track record of implementation?

- Staff believe that Gabon's capacity to meet potential repayment obligations to the Fund remains adequate, albeit subject to significant risks, on the basis of strong corrective actions undertaken by authorities which will prevent further fiscal slippages and ensure that the program implementation remains on track.

27. The authorities have started to hold regular meetings to update their monthly cash flow plan of revenues, expenditures, loan disbursements, debt repayment schedules, and the remaining arrears clearance plan to avoid short-term liquidity shortfall and the risk of re-accumulation of arrears. While it is a welcoming step, it might be

better to consider further systematic measures, such as concentration of capacity to owe debt into a single Ministry. Staff's comments are welcome.

- The program currently includes two structural benchmarks for 2018 which aim to address this issue: (i) the creation of a single unit responsible for the financial oversight of public entities, including for gathering and coordinating financial information provided these entities and (ii) publishing a new decree establishing harmonized statutes for public administrative institutions that include provisions to harmonize statues of public administrative institutions as well as strengthen financial oversight of these entities.

Financial Sector

28. Can staff provide additional information about the hiring of an international consultant to assess options going forward for the two public banks in liquidation?

- In line with the MEFP commitment, the authorities are currently looking for an international consultant to assess the options going forward for the two public banks in liquidation. At the same time, they have also expressed the interest for further technical assistance in this area.

29. We are surprised that the resolution of the three public banks seems not to have advanced since the last program review. Staff's comments would be appreciated.

- Two of the public banks in financial distress are currently under liquidation and the third is under management. A key factor delaying liquidation/resolution is the need to evaluate options to ensure that financial services are not disrupted in rural areas (critical for financial inclusion) as well as financing for small- and medium-sized enterprises.

30. We remain concerned by the three public banks in financial distress, and would appreciate staff comments on the fiscal costs of their liquidation/resolution.

- Estimates of the fiscal costs for the liquidation/resolution of the three public banks in distress are 0.4 percent of GDP and 0.9 percent of GDP in 2018 and 2019, respectively.

31. ***We are concerned, however, by the indication that limited information has been provided by the authorities concerning the structural benchmark on the assessment of options for the resolution of the three distressed public banks. Staff judges rightly that this structural benchmark was not met. However, we note that there is no proposed structural benchmark for 2018 to follow up on this reform. Staff***

clarification is welcome. In the same vein, could staff elaborate on the rationale behind the recent decision by the government to acquire additional shares in the third largest bank while at the same time a plan is being developed to privatize its non-strategic shareholding?

- Options for the resolution of the three distressed public banks could become either a prior action for the next review or a structural benchmark once an international consultant has been hired as recommended in the staff report.

- The authorities have acquired a non-strategic shareholding in the third largest bank because the previous majority owner (BNP Paribas) wanted to sell its shares. The government had sought a buyer. A foreign financial group expressed interest in buying BNP Paribas's shares, but the government did not allow the operation given that another group from the same country already owns a bank in Gabon (UGB).

- Given the stalemate and the pressure from BNP Paribas to sell its shares, the government opted for a temporary solution in which the Sovereign Wealth Fund (FGIS) would acquire BNP Paribas' shares until the government identifies a new buyer. Note that BNP Paribas continues to hold 6 percent of the shares, and continues to provide financial and technical advice to the bank. Under this temporary arrangement, the bank has kept its current management structure, which is fully independent of the government. Under the Fund-supported program, the government is committed to selling its shares by 2019.

32. We would welcome staff comments on the provision of incomplete information by the authorities concerning the SB on the assessment of options for the resolution/restructuring of the three distressed public banks, indicated in para 10.

- As Table 3 of the MEFP indicates, the Structural Benchmark on the assessment of options for the resolution/restructuring of the public banks has not been met. Notably, the resolution/restructuring plan of the *Banque Gabonaise de Development* (BGD) has not been finalized. The corrective measure is described in paragraph 36 of the MEFP.

Statistical Data

33. Could staff update us on the recent steps under the program to improve quality and dissemination of the statistical information?

- As paragraph 43 of the MEFP notes, during the program the government has started several initiatives to improve economic statistics in Gabon. Demographic and health surveys are scheduled to be completed and published in 2018 and 2019, respectively.

The government is also committed to conducting other surveys (including poverty, companies, employment, informal sector, and household surveys) by 2019. To this end, the program has already delivered TA missions from HQ and AFRITAC on national accounts, fiscal, and balance of payments statistics.

- For example, the national accounts were revised for the period 2011 to 2015 and preparations are underway to finalize those for 2016 and 2017 by October 2018. The government financial statistics for the period 2012 to 2016 were already transposed according to the new classification of the Handbook of Government financial statistics of the IMF (GFS) and are planned to be transmitted to the statistical databases of the IMF by the end of July.

34. Regarding poverty, the staff report prepared for the first review of the Extended Arrangement stated that plans were underway to complete a new poverty survey with preliminary results expected in early 2018. Does staff have any information to share with the board on this new survey?

- With the World Bank's assistance, the poverty survey is under way and as outlined in paragraph 43 of the MEPF is envisaged to be published by end-2019, at the latest.