

ACTION MEMORANDUM FOR THE ACTING ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Timothy J. Bork 

SUBJECT: Senegal FY 1990-91 African Economic Policy Reform  
(AEPRP-II) Program Grant (685-0292) and Project Grant  
(685-0299)

I. Problem

Your approval is requested for a \$35 million grant to Senegal pursuant to Section 121 of the Foreign Assistance Act of 1961, as amended, and the Development Fund for Africa (DFA) appropriation. This grant consists of: (a) a \$32 million sector program grant to be disbursed in five tranches over FY's 1990, 1991 and 1992 when conditions precedent have been met; and (b) a \$3 million project grant for studies and technical assistance in support of Government of Senegal (GOS) banking sector adjustment measures. The total life of program funding of \$35 million will be obligated as follows: \$25 million in the first quarter of FY 1990 and \$10 million in the second quarter of FY 1991. Of the \$25 million to be obligated in the first quarter of FY 1990, \$22 million will be for the Program Grant (685-0292) and \$3 million will be for the Project Grant (685-0299).

II. Background

Senegal is in its fifth year of moderate economic recovery after more than two decades of negative per capita growth caused by recurrent droughts, oil shocks, fluctuating prices for its major products (peanuts, phosphates), and counterproductive economic policies adopted after independence. Although Senegal has a limited natural resource base, a high rate of population growth and erratic agricultural production, policy reforms supported by expanded donor assistance [since mid-1983] and generally improved rainfall [since 1985] have begun to show positive results. [Annual growth of Gross Domestic Product (GDP) averaged 3.4 percent over the past four years.]

Nonetheless, Senegal's economic recovery remains fragile. Continued reform is necessary in the agricultural and industrial sectors, and in the tax code. A.I.D. is actively aiding the GOS reform process, including a FY 89/90 ESF grant of \$20 million in support of a simplified tax system. However, despite recent GOS reform efforts, Senegal is experiencing a near-term crisis of stability and liquidity in its banking system which is undermining the entire reform process. This crisis requires short-term stabilization measures and long-term reforms to restore stability and increase the competitiveness, efficiency and outreach of the

banking sector if it is to properly perform its role of mobilizing domestic savings for localized investment in support of other GOS reforms.

Recent improvements in fiscal and monetary policy have already set the stage for required improvements in the banking sector, but are themselves insufficient to address the overhang of bad debt remaining from the early 1980s, the current liquidity crisis and the structural problems of the banking sector itself.

As the GOS now moves toward policies promoting private sector expansion, a significantly strengthened banking sector is required to more effectively mobilize Senegal's domestic savings and increase its current low level of domestic investment, thus decreasing heavy reliance on external financing to close the savings-investment gap. In addition, a strengthened, more independent, transparent and competitive banking sector is also required to reduce Senegal's comparatively high capital/output ratio by improving the allocation of investment resources.

### III. The Program

The AEPRP-II Grant Program recognizes and responds to Senegal's need for program assistance to restructure its banking sector. The program purpose is to help establish a viable banking system characterized by adequate levels of solvency, liquidity and profitability, by increased sectoral and term diversification, and by increased mobilization of domestic savings. Objectives are:

1. improved inspection and supervision of banks;
2. privatization, restructuring and improved management of banks;
3. accelerated recovery of bad debts;
4. increased mobilization of domestic savings; and
5. improved allocation of credit and outreach to all sectors of the economy.

Immediate beneficiaries include current and future bank depositors, customers, managers, employees and shareholders. A broader class of beneficiaries includes entrepreneurs, employees and customers of existing and future enterprises. Literally, the entire economy will benefit from increased savings, improved allocation of credit and general expansion as capital markets are liberalized, broadened and deepened.

The program will cover a three-year period beginning in December 1989. The \$32 million sector program grant portion of the Senegal AEPRP-II, in conjunction with A.I.D. conditionality, is designed to increase the competitiveness, transparency, efficiency, flexibility

and outreach of the banking sector. The conditionality of the sector program grant improves the internal and external management and control systems needed to prevent a recurrence of the present crisis, while assisting the banking sector to more fully address development needs by allowing it to prioritize loans and investment according to the risk assessments of the banks themselves. These measures include reducing the GOS share of bank ownership and its influence on credit allocation; consolidating and/or liquidating unprofitable banks; increasing and improving bank inspection and supervision, and reducing taxation of savings. Because of the institution-building character of many of the reforms, an estimated \$3 million of the \$35 million program will be reserved for associated technical assistance measures, including developing systems for accelerated recovery of bad debt, improved bank management, bank privatization, monetary and financial studies, and program implementation, monitoring and evaluation. Local currency made available by the sector program grant will be used to reimburse the GOS for accelerated reductions in its liabilities to the banking system.

#### IV. Analyses

##### 1. General

The Executive Committee Program Review (ECPR) met on September 21, 1989, and found that the economic, financial, institutional and impact analyses contained in the Program Assistance Approval Document (PAAD) satisfactorily justify the need for this sector support program.

The ECPR further concluded that the PAAD should be revised as follows: the purpose statement should be modified; the end-of-project status (EOPS) indicators should be quantified; details supporting the estimated technical assistance costs should be indicated; the discussion on local currency uses should include a statement of the expected developmental impact; and a section should be added outlining the program's developmental hypothesis (that a viable banking system will, over time, increase the provision of financial services and other benefits to AID's target groups) and establishing a monitoring system for tracking the necessary variables to confirm this hypothesis. These changes have been incorporated in the revised PAAD.

##### 2. Human rights

Senegal is a functioning democracy and no issues exist with respect to human rights.

##### 3. Gray Amendment

Given the Bureau's continuing efforts to maximize procurement involving Gray amendment entities, procurement requests for technical

assistance will strongly encourage the participation of minorities and women.

## V. Conditions Precedent (CP) and Covenants

The conditionality for the program is designed to reduce GOS ownership to less than 25% of any bank; improve bank management by allowing managers to make lending and personnel decisions without GOS interference; reorganize, consolidate and/or close illiquid or insolvent banks with appropriate BCEAO oversight; establish targets and timetables for recoveries of bad debt; encourage the mobilization of domestic savings; increase the frequency of BCEAO inspections and improve banking supervision, and establish the level of funding the GOS will grant to the Senegal Mission in support of general operating expenses.

### Implementation Plan and Accounting Procedures

#### 1. Cash Disbursement

Details on the transfer mechanism and accounting procedures are set out in the Draft Program Grant Agreement submitted as Annex I along with the PAAD. The procedures set forth in the Draft Program Agreement will be incorporated into the provisions of the the final Program Grant Agreement being signed with the GOS.

Senegal is a member of the West African Monetary Union (WAMU), which renders the tracking of dollar disbursements impractical as concluded in 88 State 431. Accordingly, the interim guidance applicable to ESF cash disbursement programs in WAMU countries and the procedures for carefully tracking counterpart CFA described in the above-mentioned cable will be implemented by the Mission. This program was informally brought to the attention of the relevant Congressional staff members and is not considered to be covered by the dollar tracking requirements contained in Section 592 (b) of the FY Appropriations Act.

#### 2. Project Grant

The technical assistance and studies to be funded under a complementary project grant under AEPRP-II will include consultancy services for accelerated recovery of bad debt, improved bank management and bank privatization as well as overall implementation, monitoring and evaluation of the program. Funds are also provided for studies of monetary and financial policies.

## VII. Major Implementing Agencies

The management of the Program Agreement Grant funds of \$32 million will be the responsibility of the GOS's Ministry of Economy and Finance. The management of the Complementary Grant funds of \$3 million for studies and technical assistance will be the responsibility of USAID/Senegal in cooperation with the GOS Ministry of Economy and Finance.

A.I.D. Officers responsible for the implementation of this Grant are:

Mr. Richard Greene  
USAID/Senegal

Mr. Barry Burnett  
AFR/PD/SWAP

VIII. Waivers

There are no waiver requests contained in this program.

IX. Justification to Congress

The Congressional Notification for this program was forwarded to the Congress on November 8, 1989. The fifteen day waiting period expired on November 23 without objection. You approved a 121 (d) determination for this program on August 31, 1989.

XI. Recommendation

That you sign (a) the attached Program Assistance Approval Document (PAAD) facesheet and thereby approve the program, including a life-of-project funding level of \$35 million, and authorize the first year's funding of \$22 million for the sector program grant component of the Senegal African Economic Policy Reform Program(AEPRP-II), 685-0292, and (b) the attached Project Authorization and Project Paper (PP) facesheet and thereby approve life of project funding of \$3 million for the studies and technical assistance component, 685-0299.

Attachments:

- AEPRP-II PAAD
- AEPRP-II Project Authorization
- AEPRP-II Project Paper Facesheet

Clearances: AFR/SWA:PDichter PSide  
PPC/PB:Rmaushammer 100 11/20/89  
GC/AFR:PJohnson (Draft)  
AFR/MDI:WWeinstein WJ  
DAA/AFR:ELSaiers \_\_\_\_\_  
AFR/DP:JWestley JW 11/20/89

Drafter: USAID/SENEGAL:MBeye/AFR/PD/SWAP:BBURNETT/RKERR:6829P RCX