ABSTRACT

Economic Recovery in the Gambia:
Lessons for Sub-Saharan Africa

Edited by

Malcolm F. McPherson
Steven C. Radelet

September 1992

In mid-1985, The Gambia formulated and began implementing none of the most comprehensive economic adjustment programs devised by any country in Sub-Saharan Africa. By mid-1986, the Gambian economy had begun to turnaround, and the economy has continued to expand since then. This book asks how The Gambia, which was widely seen as a "basket case" in mid-1985, recover so dramatically?; what lessons can other SSA countries learn from The Gambia's experience?; what lessons have Gambians themselves learned?; and What additional measures would transform the recovery into a program of long-term growth and development?

The essays in this volume help answer these questions. Specifically, they examine:

- the circumstances which led the government to adopt such a wide-ranging set of policy changes;
- the rationale for and impact of the policies;
- the problems encountered as the policy changes were being implemented;
- the unanticipated adjustments made as the ERP progressed; and
- additional actions needed to provide the basis for sustainable long-term growth.

The essays address the following areas: The Gambia Economic Recovery Program (ERP); exchange rate reform; macroeconomic reform and agriculture; the groundnut sector; capacity improvement in the Ministry of Finance; parastatal reform, performance contracts and privatization; monetary policy and financial reform; rural credit and savings; budget reform during the ERP; tax reform; customs reform; recurrent costs and the public expenditure program; external debt management; rationalizing domestic debt; donor support for the ERP, accounting for growth under the ERP; the politics of economic

reform; the program for sustained development; and lessons from the ERP for Sub-Saharan Africa.

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and
Steven C. Radelet

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Dedication

To the memory of
Sheriff Saikouba Sisay
Minister of Finance, 1982-1989

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Dedication

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Preface

In 1985 HIID began working on a sustained basis with the Ministry of Finance of the Government of The Gambia. The leader of the Ministry at that time and for the next four years until his death, Mr. Sheriff Sisay, was an effective and dedicated Minister who was determined to reverse a decade of decline in the Gambian economy. It was our privilege to work with him, his successors and the career staff of the Ministry. Through this joint effort the decade of decline was turned into seven years of growth and the beginnings of more fundamental institutional reform.

HIID left The Gambia in 1992 when our second contract financed by the United States Agency for International Development came to an end. During the seven years in which HIID managed the Economic and Financial Policy Analyses Project, more than 30 HIID staff and consultants participated. Because the Gambians we worked with demonstrated over and over that they were serious about reform, they attracted to their country some of the ablest talent HIID has to offer. Many of those who participated in the project have contributed essays to this book. HIID's team leader for the first four years of this project was Malcolm McPherson who continued as project backstopper on his return to Cambridge. He was succeeded by Brendan Walsh and finally by Charles Mann. Working with the team leaders on a resident basis were Steven Radelet, Paul McNamara, and Andrew Adam, all graduates of the public policy program of the Kennedy School of Government at Harvard.

In many ways the reform effort in The Gambia and the technical assistance that contributed to it was a model of how these kinds of programs should work but all too infrequently do. Leadership and all of the major decisions were made by the Gambian government officials elected or appointed to that role. HIID's role was to strengthen the limited analytical skills of the Ministry of Finance that provided the input into these decisions. We did that in two ways, by providing training for The Gambian civil servants in the Ministry and by filling gaps with resident advisors and outside consultants. During the seven years, more than 75 Gambians were sent abroad for short and long-term training. Others learned on the job. The long term advisors brought in a range of macro, quantitative and computer skills that helped The Gambia to deal with donors such as the International Monetary Fund on The Gambia's own terms rather than as supplicants. Short term consultants provided international experience and special skills that no small developing country could reasonably expect to have within its own population.

This book, therefore, is really a case study of how significant policy reform is possible in Sub-Saharan Africa and the ingredients that are required to make that possibility a reality. HIID is grateful to all of those who make the success of the project possible. We wish to thank the U.S.A.I.D. mission personnel in Banjul who not only funded the project, but helped us deal with the sometimes mystifying processes of the A.I.D.

bureaucracy and we are grateful to the external reviewers who twice, in 1987 and 1990, reviewed and roundly praised the project and its contributions to The Gambia's economic recovery.

Most of all, however, our gratitude goes to the leaders and staff of the Ministry of Finance of The Gambia. It was they who had to ultimately decide on and carry out the reforms often against considerable resistance.

Dwight H. Perkins
Director, Harvard Institute for International Development
September 1992

List of Acronyms

ARP	Administration Reform Program
Atl Hot	Atlantic Hotel
CGE	Computable General Equilibrium
EC	European Community
ECOWAS	Economic Conference of West African States
EDP	Electronic Data Processing
EFPA	Economic and Financial Policy Analyses Project
ERP	Economic Recovery Program
ESAF	Enhanced Structural Adjustment Facility
FY	Fiscal Year
Gam A/W	Gambia Airways
GAMTEL	Gambia Telecommunication Company
GCDB	Gambia Commercial and Development Bank
GCU	Gambia Cooperative Union
GDP	Gross Domestic Product
GEDRES	Gambia External Debt Reporting System
GNIC	Gambia National Insurance Corporation
GNP	Gross National Product
GOTG	Government of The Gambia
GPA	Gambia Ports Authority
GPMB	Gambia Produce Marketing Board
GPTC	Gambia Public Transport Corporation
GUC	Gambia Utility Corporation
HIID	Harvard Institute for International Development
IDB	Islamic Development Bank
IMF	International Monetary Fund
ITD	Income Tax Division
LMB	Livestock Marketing Board
MDI	Management Development Institute
MEPID	Ministry of Economic Planning and Industrial Development
MFEA	Ministry of Finance and Economic Affairs
MFT	Ministry of Finance and Trade
NA	Not Available
NIB	National Investment Board
NTC	National Trading Corporation
ODA	Overseas Development Administration
PEP	Public Expenditure Program
PIP	Public Investment Program
PE	Public Enterprises
PMO	Personnel Management Office
PPP	People's Progressive Party
PSD	Program for Sustained Development
SAC	Structural Adjustment Credit
SAF	Structural Adjustment Facility
SAP	Supplementary Appropriations
SDR	Special Drawing Right
Sen Hot	Senegambia Hotel
SSA	Sub-Saharan Africa
SSHFC	Social Security and Housing Finance Corporation
UN	United Nations
UNDP	United Nations Development Program
USAID	United State Agency for International Development
WACH	West African Clearing House

1

Introduction and Overview of the Essays

Malcolm F. McPherson and Steven C. Radelet

1. Introduction

In mid-1985, The Gambia formulated and began implementing one of the most comprehensive economic adjustment programs devised by any country in Sub-Saharan Africa (SSA). The adjustment effort, formally known as the Economic Recovery Program (ERP), had two objectives - to halt the deterioration of the economy, and to lay the foundation for sustained economic growth. By mid-1986, just a year later, the Gambian economy had begun to turnaround.

It is now seven years since the ERP was introduced and the economy continues to expand. In the interim, there has been two general elections. The austerity measures taken under the ERP produced no riots or disturbances and, throughout the whole process, The Gambia has retained its reputation as a stable, peaceable democracy with a human rights record in Sub-Saharan Africa second to none.

How did The Gambia which was widely seen and treated as a "basket case" in mid-1985 recover so dramatically? Are there any lessons from The Gambia's experience which other countries in SSA can draw? What lessons have Gambians themselves learned? What additional measures would transform the recovery into a program of long-term growth and development?

The essays assembled in this volume help answer these questions. Specifically, they examine:

- the circumstances which led the government to adopt such a wide-ranging set of policy changes;
- the rationale for and impact of the policies;
- the problems encountered as the policy changes were being implemented;
- the unanticipated adjustments made as the ERP progressed; and
- additional actions needed to provide the basis for sustainable long-term growth.

These points provide a framework for placing the ERP in context both in relation to the Gambian experience and the broader patterns of economic adjustment througnout SSA.

To begin creating that context, the remaining sections of this chapter will review the issue of economic adjustment in SSA, the process of economic decline, and the broad developments in the Gambian economy which led the government to adopt the ERP. We conclude with a brief review of how the volume is arranged and its contents.

2. Economic Decline and Adjustment in SSA[1]

a. Economic Decline in SSA

Throughout SSA, economic deterioration has become self-perpetuating - and even self-fulfilling. Current macroeconomic trends, many countries are likely to stagnate or continue regressing for the foreseeable future.[2] For a large number of countries, per capita real incomes are now lower than they were in the mid-1960s, rates of investment have fallen, money and credit have grown dramatically relative to changes in real income and productive capacity, inflation has been high, exports have decreased, the capacity to import has declined, domestic savings have fallen, and external debt has reached insupportable levels. Reversing this situation will not be easy. Recovery efforts are handicapped by the overhang of foreign debt, deterioration of the resource base, the limited supply of motivated, skilled personnel, and institutions which rarely achieve their stated objectives.

Country specific data reveal the general pattern of economic disintegration and retrogression even more starkly. Examples include those which have been relatively stable - Tanzania, Zambia, Ghana, and Senegal - as well as those which have undergone civil wars - Uganda, Angola, Sudan, Chad, Somalia, Liberia, and Ethiopia. Evidence of the degree to which these economies have retrogressed is that they have de-industrialized and agriculture now makes a larger contribution to GDP than it did two decades ago. Both of these changes are contrary to the "normal patterns" of economic development.

Indeed, the pattern of decline has been so extensive and so pervasive that a set of stylized facts can be identified. These relate to every aspect of the economy - production, expenditure, income generation, finance, and wealth. Common problems include:

- low productivity of capital and labor;
- declining output in key sectors, particularly agriculture;
- bias against exports and the domestic production of import-substitutes due to an overvalued exchange rate;
- deterioration of physical infrastructure through disinvestment and the lack of maintenance;
- slow growth of public sector revenues due to tax evasion and price controls on public services;
- accumulation of arrears on both internal and external payments;
- worsening rural-urban income gap because of the explicit and implicit taxation of agriculture;

- decline in rural welfare because of the concentration of public expenditure in the urban areas;
- income redistribution to selected entrepreneurs and government officials through influence-peddling and corruption;
- financial disintermediation because of low nominal interest rates and credit controls;
- the emergence of parallel and alternative markets to bypass official controls;
- high rates of credit creation due to excessive borrowing by the public sector to cover its deficit;
- reduction in domestic savings as a result of the loss of confidence among the general public;
- decline in foreign assets as a result of an overvalued exchange rate; and
- currency substitution and capital flight.

While the list is by no means complete, an economy with even a few of these features would be in serious difficulties. Most of these elements, however, can be found in many countries in SSA.

b. Economic Adjustment in SSA

Considerable effort has been devoted to describing and understanding why economic decline in SSA has been so pervasive.[3] Both internal and external factors have been identified, although opinions vary on their relative importance. There is agreement, however, that remedies for the economic decline require fundamental changes in economic policies combined with technical and financial support from the donor community.

Areas of disagreement remain. Opinions differ on how rapidly economic policies can and should be adjusted, the type of policy changes needed, and the appropriate form of foreign assistance. The disagreements were underscored when the Organisation of African Unity (OAU), with the assistance of the United Nations Economic Commission for Africa, published an "alternative structural adjustment program".[4] Specifically, the program advocated the gradual adoption of adjustment measures and the use of multiple exchange rates. It also argued that donor conditionality was not a useful mechanism for promoting adjustment. By contrast, the structural adjustment programs supported by the International Monetary Fund (IMF) and World Bank, of which there are approximately 30 in SSA, involve broad-based adjustment, immediate measures to eliminate exchange rate distortions, and rigid conditionality.

Neither approach has been an unqualified success.[5] Too little time has passed for their relative merits to be distinguished from the effects of other changes. The deterioration in many

countries has been so extensive that economic recovery, by whatever means, will take a long time. Moreover, institutional problems have been far more serious than anticipated. Overcoming them will be difficult. Some have attributed them to "mediocre leadership"[6]; some see them as resulting from the absence of "agencies of constraint";[7] and still others associate them with a general lack of accountability derived from cronyism, nepotism opportunism, and corruption.[8]

The recent focus on "governance" and political reform may provide some useful insights.[9] Much, however, has to be done.[10] Donor agencies, for example, are only now defining an agenda.[11] Efforts at political reform designed to return countries in SSA to systems of responsible government are just beginning. The recent elections in Zambia were encouraging but potentially tougher tests - Kenya, Malawi, and South Africa - lie ahead.

c. Economic Circumstances in The Gambia

Many of the stylized facts can be identified in The Gambia's experience. By mid-1985, its economy was in deep trouble. Relative to GDP:

- external arrears exceeded 50%;
- foreign debt was approaching 250%;
- the current account deficit on the balance of payments was more than 30%; and
- the public sector (government and public enterprise) deficit was around 25%.

Furthermore:

- inflation was accelerating;
- real per capita income was declining;
- capital flight had reached major proportions;
- currency substitution was well advanced;
- agricultural production was falling;
- real investment was declining;
- the physical infrastructure (roads, bridges, schools) was deteriorating;
- shortages of basic commodities (fuel, rice, and spare parts) were common;
- business confidence was low;
- the country's international creditworthiness had evaporated; and
- donors had suspended all aid except for humanitarian assistance.

These difficulties had taken several years to reach crisis proportions. Most of them were well-known to the government and its advisors but action was delayed. Why did the government wait

so long to act constructively? And, what prompted the government to act when it did? Moreover, for several years, The Gambia like many other countries with similar difficulties chose to "muddle through" with half-hearted efforts at adjustment. What happened to encourage, or force, the government to break so dramatically with its past pattern of behavior?

The Gambian story provides answers to these questions in a way which provides insights regarding some of the choices and pressures confronting other governments facing similar circumstances. In particular, The Gambia shows that, despite the massive internal and external imbalances, economies can recover relatively quickly. For recovery to succeed, however, there needs to be a mutually reinforcing set of policy changes, leaders who remain committed to the implementation of the policies, and adequate support from the donor community. The Gambian experience also shows that recovery can be achieved without undermining established democratic traditions or compromising basic freedoms and individual rights.

What the Gambian experience has not yet shown, however, is how small, open, aid-dependent countries can move beyond the stabilization and adjustment phases of recovery to a pattern of sustained reform. Changes in leadership, the reduction of donor vigilance, and/or concerted resistance to specific policy changes often lead to lapses in policy implementation. Once recovery is underway, recollections of economic difficulties begin to dim, political priorities shift, opponents of reform become more focused in their resistance, and donor conditions which were accepted during the height of the crisis no longer appear reasonable. Moreover, because economic recovery is associated with rising incomes and aid flows, the scope for a resurgence of opportunistic behavior expands. Since that behavior was often a major cause of the original economic difficulties, corruption can quickly re-emerge on a large scale.

No country in Africa, including The Gambia, has demonstrated that type of anti-development behavior can be contained.[12] The recent donor actions with respect to Kenya and Malawi, and the response that it has elicited from Presidents Moi and Banda, suggest that fundamental changes in governance will occur slowly and then only after intense external pressure. Greater accountability is not high on the agenda of any African leader. Indeed, the Gambian experience highlights the point that without basic modifications in the degree to which leaders are held accountable for the economic consequences of their actions - and failure to act - African countries will not succeed in laying the foundation for sustainable growth and development.

3. Organization of the Essays

We have organized the essays around the basic themes of the ERP - exchange rate reform, the promotion of agriculture and other productive sectors, civil service reform, reform of monetary and fiscal policy, parastatal reform, improved public investment, and debt management. The final sections have additional material designed to round out the technical aspects covered in the earlier chapters. They include essays on the politics of reform, the directions followed under the program for sustained development which succeeded the ERP, and a review of the ERP from a political and economic perspective.

We have chosen this format in order to help:

- place the ERP in context;
- discuss its specific themes;
- highlight the strengths and weaknesses of the reform effort;
- point to additional changes needed to consolidate the reforms; and
- draw lessons from the ERP for other African countries.

This approach, we feel, will be of the greatest assistance to the policy makers and their advisors in African countries who are in the process of formulating or reformulating programs to revive their economies. It should also suit those members of the donor and academic communities who are interested in the specific aspects of economic adjustment and reform. Students of comparative economic and political systems may find the final chapters of some relevance.

The arrangement of the essays, on its own, provides some immediate lessons about economic adjustment and reform. It is never neat and all of the relevant issues cannot be anticipated in advance. In our attempt to follow the themes of the ERP, some issues which were vital to the initial success for the recovery program (such as customs reform) could not be easily categorized. Another lesson is that adjustment is highly skill- and time- intensive. The essays represent a partial summary of some of the activities of only one group of social scientists over a period of close to a decade. Whatever achievements they may have made has depended in a variety of ways on the contributions of many others, inside and outside the government and the donor community.

4. Review of the Essays

The Economic Recovery Program: Background and Formulation. The general degree to which the Gambian economy had deteriorated was quite extraordinary. This essay provides some perspective on the

size and nature of the economic imbalances which existed and the various pressures and limited options faced by the government when it decided to formulate and implement the ERP. An important aspect of the formulation of the ERP was its openness. The main provisions were widely discussed and publicly shared. The policy makers avoided major policy surprises. This greatly facilitated their implementation.

Exchange Rate Reform in The Gambia. The exchange rate became progressively overvalued from the mid-1970s onward. The government was unwilling to devalue and the situation go out of hand. Foreign debt grew rapidly, foreign arrears mounted, and a parallel exchange market began to flourish. Capital flight and currency substitution were common. The official rate became largely irrelevant. Under the ERP the government floated the dalasi and removed all restrictions on foreign exchange transactions. With an appropriate set of supporting policies, notably market-determined interest rates, and a reduction in the budget deficit, together with balance of payments support from the donors, the exchange rate has stabilized.

Macroeconomic Reform and Agriculture. A major reason for the poor economic performance of the Gambian economy was the collapse of agriculture. Drought and fluctuating prices for exports were important factors. Inappropriate policies were significant as well. Government-determined producer prices were too low, the exchange rate was overvalued, public investment in agriculture was inadequate and misdirected, and the public enterprises associated with agriculture taxed rather than supported the sector. The ERP gave particular attention to the revitalization of agriculture. Groundnut production was subsidized, prices were decontrolled, and measures taken to reduce the costs on farmers imposed by public enterprises. Agriculture has responded. Its longer-term growth, however, is constrained by serious resource constraints.

The Groundnut Sector. The Gambia's principal domestic export has been groundnuts. In the early 1970s, both production and revenue in the sector increased rapidly. That situation changed dramatically in the late 1970s and early 1980s. In order to give the agriculture sector a boost and stimulate exports, the government, as part of the IMF/World Bank adjustment program, agreed to subsidize the price of groundnuts. In 1986, that subsidy represented more than 8% of GDP. The subsidy could not be sustained and groundnut prices fell substantially over the next three years.

Capacity Improvement in the Ministry of Finance. Throughout the 1970s, the Gambian civil service had expanded rapidly and its efficiency deteriorated. A major thrust of the ERP was to rationalize the size of the civil service and improve its organization. A program for the systematic restructuring of all ministries was formulated. To its detriment, the ministry of

finance was basically untouched by the reorganization. There was, however, a major effort made to improve the skills of the ministry staff. This took the form of short and long-term training, computerization, and on-the-job training using visiting consultants.

Parastatal Reform, Performance Contracts and Privatization. With the collapse of the groundnut sector, an important source of fiscal revenue, namely revenues generated by the Gambia Produce Market Board, disappeared. With the government persistently in deficit and most public enterprises making losses, the whole public sector became a major economic drain on the economy. The ERP emphasized two methods for rationalizing the operations of the PEs. One was a system of performance contracts which set out the separate responsibilities of the government and each PE. The other was privatization. The activities took considerably longer than had been anticipated. Both have encountered considerable local resistance which has only been overcome by donor pressure.

Monetary Policy and Financial Reform. With a budget deficit that averaged 10% of GDP between 1965/66 and 1985/86, the government has been a large borrower, both domestically and abroad. Moreover, in an attempt to "promote" development, the government established its own central bank and commercial bank. The credit policies pursued by these organizations were highly expansionary. With a fixed exchange rate, declining export revenues, and limits to the levels of foreign aid, serious pressures built up on the financial system. Inflation accelerated, the exchange rate became increasingly overvalued, and capital flight and currency substitution became the norm. Financial reform under the ERP involved liberalizing interest rates and rehabilitating the public financial institutions. The central bank also needed technical assistance.

Rural Credit and Savings. A perennial excuse for subsidizing rural credit in The Gambia has been that farmers are "poor". Encouraged by this notion, the government directed large amounts of subsidized credit to the farming community. Little of this was repaid. Ultimately, the institutions involved, the cooperative union and the commercial and development bank, became insolvent. Reorganizing these institutions is taking considerable time and effort. For institutional credit to serve a useful role in agriculture the financial behavior of and constraints facing rural producers have to be understood and addressed.

Budget Reform During the ERP. Reforming the budget in The Gambia has proved to be intractable. Seven years after the introduction of the ERP, the only significant changes in the budget have come about at the insistence of the donor community.

Tax Reform in The Gambia. Even prior to the introduction of the ERP some important initiatives had been taken to reform the system of direct and indirect taxes. The Gambia has always been, and

remains, heavily dependent on taxes on international trade. Senior government officials have appreciated the risks of that dependency and measures were sought to broaden the tax base. The reform of the direct tax system focused on efforts to improve tax compliance, reduce the administrative burden, and make the system more equitable. Indirect tax reform aimed at broadening the domestic tax base. Finally, the reform of the investment tax incentives was designed to make the system more transparent and reduce leakages.

Customs Reform in The Gambia. Although the ERP involved a comprehensive set of policy changes some measures were not anticipated. Customs reform is an example. In response to a sharp drop in revenue collections the minister of finance directed his staff to review the matter. Their investigation revealed major customs fraud. The actions taken to reduce fraud significantly reduced the government deficit and domestic credit creation. Inflation declined and the exchange rate stabilized. Indeed, without the reduction in custom fraud the ERP could not have succeeded. Nonetheless, it has been exceedingly difficult to prevent a resurgence of fraud.

Recurrent Costs and the Public Expenditure Program. With the dramatic expansion in public investment in the mid 1970s onward, serious problems arose in providing the resources needed to operate and maintain the capital created by that investment. An acute recurrent cost problem emerged. The economic difficulties of the 1980s simply accentuated the problem. The ERP gave particular attention to funding operations and maintenance expenditures rehabilitating the public sector capital stock.

External Debt Management. Until the mid-1970s, The Gambia made few external commitments. But by the early 1980s, the volume of debt had grown rapidly. Due to a foreign exchange shortage, the debt could not be serviced. As a means of restructuring and reorganizing the external obligations, a debt management system had to be developed. This was a time-intensive task. Many records were missing, many debts were unrecorded, and few government officials had the motivation to straighten out the record. Debt was seen as someone else's problem.

Rationalizing Domestic Debt. The rapid expansion of the public sector could not be financed. Taxation receipts and domestic borrowing from the non-bank public were inadequate. Over time, the government and its agencies began to borrow at increasing rates from the banking system. Eventually, the government simply failed to pay its obligations. Domestic arrears reached major proportions and took considerable effort and several years to unravel.

Donor Support for the ERP. Because of the fragile state of the government's finances and its limited policy making capacity, the success of the ERP depended heavily on timely and generous support from the donor community. The support took a variety of forms -

commodity aid, technical assistance and balance of payments finance. Commodity aid (food and fuel) was important in easing key constraints in the first three years of the ERP. Technical assistance allowed the government to deal with the complex policy and monitoring problems associated with the ERP. The balance of payments support helped The Gambia service its foreign debt and rationalize its external arrears.

Accounting for Growth under the ERP: Results from a CGE Model. A principal reason why the ERP succeeded was the comprehensive nature of the policies which the government implemented. There were fortuitous external developments, such as an end to the Sahelian drought. Donor support was important as well. A macroeconomic model was used to determine which of these factors - policies, luck, and aid - made the most significant factor.

The Politics of Economic Reform. The economic difficulties which The Gambia experienced took years to emerge. Political factors played a major role. For the ERP to be formulated and implemented, many of those factors had to be neutralized. In the face of concerted local resistance, the ERP was successfully implemented. Key elements in its success were leadership by the minister of finance and donor vigilance to ensure that conditions agreed to were met.

The Program for Sustained Development. The ERP was a four year program. Its objectives were to turn the economy around and lay the base for sustained growth. It achieved the first objective and made some progress toward the second. The government recognized that more needed to be done. It prepared the program for sustained development which has been designed to build on the success of the ERP. The principal challenges are to push ahead with the policy initiatives introduced under the ERP so as to sustain the momentum achieved so far. Mobilizing more resources domestically and using them productively will be vital to this effort.

Lessons from the ERP for Sub-Saharan Africa. Many countries in SSA have begun to address their structural problems. The Gambia has been more successful than most. The final chapters concludes the study by drawing the lesson from the ERP out in ways which are relevant to other African countries.

Endnotes:

1. The following section draws on McPherson and Zinnes (1991) and McPherson (1992).

2. Numerous data bases now exist through which movements in major economic aggregates can be traced (World Bank 1989a; 1991; USDA 1990).

3. World Bank 1981a; 1984; 1986; 1989a; OAU 1980; 1989; United Nations 1986; Ravenhill 1986; Loutfi 1989; McPherson and Zinnes 1991.

4. OAU 1989. That study has been subsequently updated.

5. World Bank 1988; World Bank/UNDP 1989; Gallagher 1991; Radelet 1992.

6. Mwaipaya 1980; Mazrui 1980:Ch.1; Obasanjo 1987:Ch.1.

7. Collier 1991.

8. Dumont 1969; Hyden 1983; Sandbrook 1987, 1990; Parfitt and Riley 1989; Klitgaard 1988; Hyden and Barrett 1991.

9. Obasanjo 1987; World Bank 1989a:192; Ward 1989; Brent 1990; Hyden and Barrett 1991; Landell-Mills and Serageldin 1991; McPherson 1992.

10. For example, there is a major gap in our understanding of what has to be done, how, when, with whom, and by whom to redress the basic weaknesses of the permanent institutions of government such as the central bank and ministries of finance, justice, and works. Improving the performance of these institutions will be critical in any reform effort. A double bind exists. Economic reform is required in large part because of institutional failures; promoting economic reform, however, requires functional and effective institutions.

11. For example, the Sahel Department, Africa Region of the World Bank is currently developing institutional reform initiatives designed to address many of the issues associated with improved "governance".

12. Students of Asian development often point to corruption as an extension of the price mechanism (whereby the habitual bribe reflects the price of the public-service) or as necessary to "grease-the-wheels". In Africa, no examples of such phenomena is available. Corruption is typically resource diverting and resource draining. The principal beneficiaries are well-placed government official, their cronies, and those who operate "safe havens" for the illicit games (McPherson and Zinnes 1992).

2

The Economic Recovery Program: Background and Formulation

Malcolm F. McPherson and Steven C. Radelet

1. Introduction

The evolution of economic policy in The Gambia over the last two decades largely reflects domestic reaction to external developments. In principle, the country's small size and its reliance on trade, leaves little room for Gambian policy makers to pursue policies which are inconsistent with broad movements in international costs and the priorities of international donors. Nonetheless, in practice, policy makers have had considerable discretion over when and how they reacted to external developments. As noted in chapter 1, the government was slow to react to adverse shifts in the external economic setting. As a result, economic performance suffered.

When the government finally responded positively through the introduction of its Economic Recovery Program (ERP) in 1985, the turnaround was remarkable. Within 18 months, the economy had stabilized and was growing.

The Gambia's reform effort has been unusual because of the rapid improvements made and because the government implemented the program without overt public opposition. President Sir Dawda Jawara was re-elected with 60% of the vote just 19 months after the ERP began. The People's Progressive Party (PPP) was returned with an enhanced majority.

This chapter examines the economic conditions which prompted to government to formulate the ERP. Section 2 discusses the economic setting which preceded its introduction and the various pressures affecting economic policy. Section 3 describes how the ERP was formulated, the rationale for the mix of policies recommended, and some of the actions taken. Section 4 gives a brief overview of the initial impact of the ERP. Section 5 concludes with observations on the reasons for the success of the ERP.

2. Economic Conditions Prior to the ERP

Many factors, both external and internal, were associated with the economic deterioration which preceded the introduction of the ERP. Sharp increases in the price of imports (including petroleum products), the long Sahelian drought, low world prices for groundnuts, declining foreign aid flows, high international interest rates, poor planning, mismanagement, and inappropriate fiscal and monetary policies all contributed to the growing internal and external imbalances. The adverse effects of some factors, such as the overvalued exchange rate and the government budget deficit, were evident in the late 1970s.[1] However, it was not until early 1982 when foreign payment arrears began to accumulate rapidly that the full extent of The Gambia's difficulties emerged. From that point on, the economic deterioration accelerated.

Some perspective on the change in The Gambia's economic circumstances can be gained by comparing the country's economic performance during the first and second decades after independence, 1965/66 to 1975/76 and 1975/76 to 1985/86. The beginning of the second decade, 1975/76, is a useful dividing point in the comparison as it coincides with several important structural changes. Externally, the first oil shock began to have a major impact on world prices, the international donors sharply increased their aid, and the pattern of rainfall in the Sahel became increasingly erratic.[2] Internally, the introduction of the first five-year plan dramatically changed the government's role in the economy.[3] The comparison ends with 1985/86 because by then some of the measures introduced under the ERP, particularly the exchange rate reform, the liberalization of rice marketing, and improved budget discipline, were taking effect. It was also the time when The Gambia's international financial standing began to improve once the country's arrears to the International Monetary Fund (IMF) were paid. Table 1 gives selected data from the two decades. (The data in column 4 cover the ERP itself.)

The second and third columns show that economic performance diverged markedly over the two decades. During the first decade, aggregate real income increased substantially, average per capita income rose, inflation was moderate, and the foreign exchange rate was stable - indeed, the dalasi was revalued by 20% in 1973.[4] Foreign exchange reserves accumulated, foreign debt was small, the government's recurrent budget was in balance, average groundnut production was high and rising, and imports were broadly in line with exports. During the second decade, the growth of aggregate real income was slow (after 1981/82, real income declined), average per capita income fell, inflation accelerated, the foreign exchange rate depreciated, foreign debt increased sharply, and foreign payment arrears reached $114 million (equivalent to 58.5% of GDP) by mid-1986.[5] The government budget became unbalanced, development expenditure expanded rapidly without a major positive impact on aggregate output, foreign exchange reserves were depleted, average groundnut production declined, and imports increased well beyond the country's capacity to export.

Whereas the decade 1965/66 to 1975/76 was one in which the Gambian economy was in basic balance, the decade 1975/76 to 1985/86 was characterized by the emergence of unsustainable imbalances in both the domestic budget and the balance of payments.

Table 1: Basic Economic Data, The Gambia

	1965/6-75/6	1975/6-85/86	1985/6-88/9
Real GDP (per annum)	4.9%	2.7%	3.8%
Real GDP/capita (% per annum)	2.3%	-0.3%	0.6%
Agriculture growth/capita (% per annum)	0%	-1.2%	0.4%
Agricultural output (% of GDP)	37.8%	29.2%	29.1%
Inflation (% increase per annum)	5.0%	12.1%	15.0%
Exchange Rate (dalasi per US$) (% devaluation per annum)	-2.0%	-6.4%	-12.9%
External debt (increase per annum)	$.9m	$44.4m	$46.5m
External arrears (increase per annum)	0	+$9.2m	-$22.5m
Government Recurrent Expenditures (% GDP)	13.6%	20.7%	29.1%*
Government Budget Deficit (% GDP)	2.6%	13.2%	13.8%*
Development Exp. (% of GDP)	3.9%	12.8%	12.6%
Net Foreign Assets (avg. change per ann.)	D4.7m	-D59.3m	D108.7m
Net Domestic Credit (avg. change per ann.)	D3.7m	D42.7m	-D64.9m
Net Credit to Government (avg. change per ann.)	D1.0m	D9.2m	-D53.9m
Money Supply (% increase per annum)	14.0%	11.7%	17.1%
Food Imports (% GDP)	7.1%	15.2%	18.6%
BoP Current Account Deficit (% of GDP)	8.3%	35.9%	25.5%
Domestic Exports (annual average)	D3.8m	D6.2m	D19.4m
Exports (including re-exports) (annual average)	D3.9m	D12.7m	D132.8m
Imports (annual average)	D5.2m	D24.8m	D178.0m
Current Account Deficit	D1.5m	D17.1m	D69.4m
Groundnut sales ('000 metric tonnes/annum)	122.9	88.5	51.3
Rainfall (millimeters per annum) Basse (East Gambia)	919	822	867

* These data are inflated by extraordinary transfers to parastatals of 5.1% of GDP.

Source: Ministry of Finance and Economic Affairs, Macro Policy Analyses Unit.

The economic deterioration had several causes.[6] Externally, the petroleum price increases of 1973 and 1979 sharply raised the foreign exchange cost of fuel; the prolonged Sahelian drought reduced agricultural production, simultaneously lowering agricultural exports and raising staple food imports; international inflation increased the costs of manufactured imports; and foreign aid and soft loans, which had increased dramatically in the second half of the 1970's, declined in the early 1980's as developed countries reoriented their aid programmes. The international prices of agricultural products (especially groundnuts) fell as the agricultural surpluses generated by subsidies in the EEC, US and Japan depressed prices on world oil-seeds market; and international interest rates rose as the major industrial countries tightened their monetary policies in order to control inflation and the US increased its borrowing to cover its budget deficit.

The impact of these external events was aggravated by inappropriate economic policies and administrative weaknesses. The expenditures included in the first five-year plan (1975) were too large and too poorly managed to have a long-term positive effect on economic growth and development. Subsidies on rice, fertilizer, electricity and transport services increased parastatal losses and diverted resources from productive investment.

Government budgetary discipline eroded as supplementary appropriations became a regular feature of government budgeting, revenue collections procedures broke down, and public employment expanded sharply. The number of civil service posts expanded 70% in 1977/78 alone, and nearly doubled between 1975/76 and 1985/86. In 1975/76, the government wage bill was equivalent to 30% of the valued in groundnut production; by 1985/86 it had grown to 140%.

At the same time, price controls on staples, such as rice, cooking oil, and meat undermined farmer incomes. The overvalued exchange rate and export tax on groundnuts depressed revenues from and investment in agriculture. The prolonged drought further damaged agricultural production. The result was that the contribution of agriculture to GDP declined by 7.5 percentage points between 1975/76 and 1985/86 (Table 1).

Despite the massive increase in foreign borrowing and investment relative to GDP, productive capacity per worker declined. The government's increased involvement in the economy through the creation of public enterprises (PEs) and investment incentives such as tax abatements, guaranteed loans, and subsidized credit failed to provide the anticipated impetus to development. Due to administered prices, unproductive investment, mismanagement, and poor cost recovery, the PEs made no net positive financial contribution to the economy (see chapter 7). Thus, the whole public sector (government and PEs) became a financial drain on the economy.[7]

Many developing countries have sustained internal imbalances for extended periods by adopting policies which insulate them from the rest of the world. Because of The Gambia's limited productive base and openness to trade, there were few mechanisms by which such insulation could occur. Nonetheless, it took time for the economy's difficulties to intensify. Many of the adverse trends, such as the decline in exports relative to imports, higher rates of inflation, mounting pressure on the budget, and the erosion of foreign exchange reserves, were evident as early as 1977/78. The economy was cushioned from these difficulties for several years by the availability of foreign exchange reserves (which had reached the equivalent of 10 month's imports in 1974/75), the country's ability to borrow abroad, and the low levels of debt service (because most of the loans contracted in the 1970's had grace periods of six to ten years).

Pressure on the economy increased in phases. In 1979, foreign assets became negative, the government began to have difficulty discharging some overseas debts, and traders were beginning to hold foreign exchange offshore. By mid-1982, payment arrears had begun to accumulate rapidly. Open evidence of a parallel foreign exchange market emerged in 1983 and capital flight, about which the central bank had commented as early as 1979, accelerated. The government's attempt to raise groundnut producer prices in 1982/83 (in response to IMF pressure to increase incentives to farmers) effectively bankrupted the Gambia Produce Marketing Board (GPMB) when world prices fell sharply. The 25% devaluation of the dalasi in February 1984 merely postponed more decisive action. The foreign exchange position was further aggravated by the large food imports needed to cover the shortfalls in the 1983/84 harvest. By late 1984, the cumulative effects of these factors was having a serious effect on business confidence. Private sector investment virtually ceased, and currency substitution was widespread as locals shifted into CFA francs, pounds, and dollars.

Though the situation was serious, it became untenable when The Gambia fell into arrears with the IMF and the stand-by programme which had been negotiated in mid-1984 was cancelled. The foreign exchange situation continued to deteriorate. Gross foreign exchange reserves fell to the equivalent of two weeks of imports, and arrears to the IMF and other international creditors mounted rapidly. By mid-1985 they were approximately SDR 58.5 million ($75 million). Disbursements on many development projects were suspended, normal short-term credit facilities were withdrawn, and rice and petrol shortages became common. The premium for foreign exchange in the parallel market reached 50%. A general sense of malaise was evident. The pressure intensified when the managing director of the IMF moved to have The Gambia declared ineligible to borrow. Other donors added to this pressure when they made it clear that, unless the Government changed its economic policies, there was little that they would, or could, do to assist.[8] Time had run out for The Gambia in international financial circles.

3. The Formulation of the ERP

When it became evident that the international community had no intention of rescuing The Gambia financially, the government had to act. The Minister of Finance Sheriff Sisay assembled a task force of senior officials in June 1985 to develop a reform program. Sisay assigned staff from the ministry of finance, the ministry of economic planning, and the central bank to the task force. He also asked two expatriates to participate - an economic adviser in the ministry of finance and a World Bank economist. Sisay told the members of the task force to design as comprehensive a program as was needed to reverse The Gambia's economic decline and return it to a sustainable growth path. He instructed them not to be concerned with the political consequences of reform measures. Sisay wanted the officials to design an economically sound program - others would deal with its political acceptability.

After meeting continuously for a week, the task force produced an action plan which formed the basis of the ERP. The major elements of this program - exchange rate reform, the promotion of agriculture, the promotion of other productive sectors, civil service and parastatal reform, monetary and fiscal policy measures, the reorientation of the public investment program (PIP), ant the rationalization of the external debt - were announced in the 1985/86 budget speech.

a. Rationale for the Measures Proposed

What the ERP task force intended, and ultimately what it achieved, was to design an adjustment program which built on and enhanced the complementarities and interdependencies which already existed within the Gambian economy. The medium term objectives of the ERP (which were later to become part of the series of policy framework papers developed by the IMF and World Bank) were:

- restore The Gambia's international credit-worthiness;
- revitalize the productive sectors, especially agriculture;
- reduce government activity in the economy to a level consistent with its resource base;
- rationalize the relationship between the activities in which government can and should have some involvement and those where the private sector is the most competent to take the lead;
- restructure the financial system so as to provide a solid foundation for sustained financial development;
- strengthen existing public sector institutions through staff rationalization, redeployment and training;
- improve the effectiveness with which existing capital facilities are maintained and used; and
- refocus public sector investment to directly complement the expansion of productive activity throughout the economy.

The seven elements of the ERP contributed directly to these objectives. The exchange rate reform was an essential part of removing the main distortions from the system of payments and exchange. Because parallel market had effectively undercut the official exchange rate and the accumulation of foreign arrears had reached such major proportions, anything less than a full-blown market-oriented solution which exposed the exchange rate to all economic pressures would have been inadequate. An added advantage of the exchange rate reform is that it would promote and sustain a major real devaluation of the dalasi. That would be a key element in restoring the attractiveness of agriculture and reverse the trend of declining rural real incomes which had been exacerbated by production declines (due to drought) and low farm gate prices (due to price controls and the misaligned exchange rate).

Revitalizing agriculture was essential if the ERP were succeed. Other productive activities, such as fisheries, tourism, business services, and small manufacturing, needed to be promoted as well, especially if a solid basis for future growth were to be created. The data in Table 1 have clearly shown that agriculture had been particularly hard hit in the decade prior to the ERP. Given the poor performance of aggregate GDP, other productive activity had not fared well either. That situation had to be dealt with decisively.

Important to that task was a complete rationalization of both the size of the public sector and its relation to economic activity. As already noted, the public sector had expanded too far, too fast. It had become a major drain on the economy.[9] Reforming the public sector had several dimensions. The civil service had to be reduced, reorganized, and re-directed. The PEs had to be restrained from engaging in socially unproductive activities. The efficiency and effectiveness of public sector programs had to be greatly enhanced. A key element in this regard was the re-orientation of the public investment program from new capital projects to rehabilitation and reconstruction. With The Gambia's external and internal debt stood at levels that could not be serviced, the overall efficiency of all public sector resources had to be enhanced. Accordingly, the reduction of waste was a major thrust of the ERP. Physical resources had to be maintained adequately, unproductive workers had to be retrenched, loss-making activities had to be discontinued, and welfare-reducing activities had to be abandoned. In effect, the claim by the public sector on the economy's resources had to decline at the same time as its contribution to income and welfare increased.

A basic requirement was a major sustained reduction in the budget deficit. Notwithstanding the fact that the external events had made economic management more difficult during the latter part of the 1970s, the economic imbalances in The Gambia had been perpetrated by irresponsible public sector spending policies. None of The Gambia's economic imbalances could have become so extreme if

the government had pursued a responsible fiscal policy. Consequently, economic adjustment would be impossible without a major change in the public sector budget. That change would also have important repercussions on monetary policy and the financial system.

Because the government had essentially run a ponzi scheme in the years immediately prior to the ERP - of issuing new debt to cover its debt service - the financial system had come under severe strain. That strain had been intensified by a compliant central bank which allowed real interest rates on loans and deposits to become highly negative and failed to adequately supervise the local financial system. The government had added to the problem by using the state-owned GCDB as a grant-making organization.

A final element was the rationalization of The Gambia's external debt. With the threat of being declared ineligible to borrow from the IMF because of its arrears, The Gambia risked the prospect of losing all credibility in international financial circles. The sheer volume of debt was overwhelming and could not be serviced. It therefore had to rescheduled and refinanced.

All of these initiatives were mutually complementary. For instance, the success of the exchange rate reform, depended on the adoption of an appropriate interest rate policy and reductions in the public sector deficit. The latter depended on improvements in the efficiency of the civil service and the disengagement of public enterprises from loss making and welfare reducing activities.

b. Implementation of the ERP

Upon announcing the ERP in his budget speech, the minister of finance began to immediately implement some of its measures. The importation and marketing of rice was liberalized, the producer price of groundnuts was sharply increased, and the fish export tax was liberalized. The government affirmed the previously-adopted ban on the creation of new civil service posts and the freeze on civil service wages.

In September, the central bank raised interest rates. In December, the Gambia Public Transport Corporation (GPTC) increased public transportation fares, the ministry of finance raised the prices of petroleum products, and the government adopted a moratorium on contracting or guaranteeing new non-concessional medium-term debt. In January the Gambia Utilities Corporation (GUC) raised both water and electricity charges, and the government liberalized the fertilizer market. Also in January, the ministry of finance floated the dalasi by establishing an interbank market for foreign exchange and lifted all restrictions on capital flows. The government initiated a crackdown on customs fraud in February; and in May, it laid off 1644 temporary employees and abolished 280 vacant civil service posts, reducing the number of civil servants

by nearly 10%.

During the second year of the ERP, the government sharply increased the producer price of groundnuts for the second year in a row, this time to well above world market levels as a requirement for support from the IMF (see chapter 5). It raised taxes on petroleum and rice and lowered import duties on many other items.[10] The central bank established a treasury bill tender system to determine market interest rates; the ministry of finance and central bank rescheduled debts with the Paris Club; the government laid off an additional 291 temporary employees and 922 established staff and abolished 816 vacant civil service posts, reducing the number of government employees by an additional 8%; and the ministry of economic planning revised the public investment program to include stricter investment criteria. The government divested its shares in a bank and a trading company and took over D72.6 million of government-guaranteed, and mostly non-performing, debts from the Gambia Commercial and Development Bank (GCDB). In order to better cover their costs, the GUC and GPTC raised their rates again.

New initiatives continued in 1987/88: the MoF introduced a national sales tax and restructured the income tax system; the central bank refinanced its London Club debts; and the government paid off D80 million of the Gambia Produce Marketing Board's GPMB) accumulated debts with the central bank. The president signed performance contracts with three public enterprises (see chapter 7); the government reorganized the ministry of agriculture and began the process of reshaping the GCDB; and Parliament passed a revised Development Act.

The breadth of the reforms, most of which were introduced over a relatively short period of time (eighteen months), was striking. They affected nearly every area of economic activity. At the same time, other important non-policy changes were also influencing the economy. First, rainfall increased nearly 30% over the early 1980s drought levels. Second, the world price of rice (the largely imported urban staple food) fell sharply just after the float, briefly reducing the domestic price to below the pre-float level. Third, to support the adjustment program, donors and commercial banks provided financing that averaged the equivalent of 43% of GDP between 1986 and 1989, almost double the level of the early 1980s. Although this represents a huge amount of resources, most of the aid was <u>not</u> used to finance the current account deficit. About two-thirds was used to retire debt service arrears and increase reserves, rationalizing the implicit borrowing The Gambia had undertaken in the early 1980s. Foreign financing utilized for current investment and consumption actually <u>declined</u> during the period, as reflected in a fall in the current account deficit after 1987.

4. Progress of the Recovery Effort

As the foreign exchange market stabilized in mid-1986, and the government further tightened its control over the budget and monetary policy, the Gambian economy began to recover on a broad front. The extent of the recovery since 1985/86 is shown in column 4 of Table 1.

Aggregate real income increased significantly, providing a welcome increase in per capita real income. The annual rate of inflation fell to below 10%, the government budget deficit was reduced to more sustainable levels, net credit to the government from the banking system contracted sharply, and exports increased relative to imports. The current account of the balance of payments, after initially increasing, declined steadily. The overall balance of payments was positive in 1987/88 for the first time in 14 years, allowing the government to repay some of its debt service arrears and increase gross foreign exchange reserves (to the equivalent of 11 weeks of imports). Groundnut and livestock production increased, tourism expanded, construction activity surged, the range of financial services broadened, the transport and communications sector expanded, and wholesale and retail activity was buoyant.

Of all the changes which occurred, perhaps the most welcome has been the increase in per capita incomes. Real GDP increased approximately 5% in both 1986/87 and 1987/88. Particularly noteworthy is that the sharpest increases occurred in the rural areas, where the poorest Gambians live. GDP in agriculture grew by nearly 20% during the first three years of the ERP. After years of poor harvests, low producer prices, and the relative neglect of agriculture in the national development effort, this improvement was vindication of the measures taken under the ERP. More importantly, because the ERP redirected income to the poorest members of Gambian society, it was one of the most potent forces for economic development in The Gambia since independence.

Though it is important to highlight the improvements, the hardships created by the ERP should not be overlooked or minimized. The devaluation of the dalasi eroded the incomes of civil servants and those on fixed incomes; high interest rates raised the cost of institutional finance for individuals and enterprises; the reduction in government employment and redirection of government expenditure required some painful adjustments, particularly among the urban population; the reorganization of the parastatal sector increased the costs of basic services such as transport, ferries, electricity and water; the customs clean-up made competition in the business community keener (and fairer); and higher user charges and commodity prices, particularly for petrol, raised costs for businesses and individuals.

Nevertheless, these difficulties have to be seen against the hardships which would have occurred in the absence of an adjustment program. Shortages of basic commodities would have increased in severity and duration; parallel market commodity prices, foreign exchange rates, and interest rates would have risen; more development projects would have been canceled as debt service arrears mounted; both inflation and unemployment would have increased; and the quality of basic services would have continued to deteriorate.

5. Lessons from the Economic Recovery Program

Numerous lessons emerge from The Gambia's experience in formulating and implementing its ERP.

First, the government's failure to react when the economy deteriorated in the early 1980s compounded the problems. This made the subsequent adjustment even more drastic and the recovery effort more protracted than it would have been had adjustment measures been taken earlier. The Gambia's economic difficulties were evident in 1979 - fundamental changes were needed then. The delay until mid-1985 transformed a difficult situation into a crisis.

Second, The Gambia benefitted from adopting a comprehensive adjustment program. By 1985, most aspects of the economy had deteriorated seriously by 1985. No single policy change or adjustment measure could have reversed the situation. For this reason, the government had to implement a broad range of changes. This approach spread the costs of adjustment more widely and reduced resistance to individual reforms. Since many of the reforms were mutually reinforcing, the general effectiveness of the overall program was enhanced.

Third, The Gambia benefitted from designing and implementing its own reform program. The process of designing the ERP focused attention on the non-sustainability of the situation in 1985. Moreover, although donors influenced the program, the government maintained control over its content and timing. This helped minimize resistance and mobilize support for the reforms, easing their implementation.

Fourth, the level of donor assistance was large enough to make a major difference to the economy. It eased the process of adjustment, allowing both consumption and investment to be higher than they otherwise would have been during the adjustment period. It also helped The Gambia repay its debt service arrears and replenish it foreign exchange reserves.

Fifth, the nature of the political environment helped. The rural power base of the ruling People's Progressive Party, the weak political opposition, and the relatively quick economic improvement

for many people all reduced public opposition and helped the PPP achieve its electoral victory 19 months after introducing the ERP. The relationship with Senegal helps explain both the Government's decision to introduce reforms and the lack of public opposition once the reforms were introduced (see chapter 18).

Sixth, individual personalities were decisive. Minister Sisay was probably the only one in the government capable of successfully introducing and implementing the ERP. His background, record, training, and relationship with the donors equipped him to head the effort and enabled him to gain the trust of the president, the public, and the donors all at once. Personalities - as much as content, timing, and process - can be critical to successful reform.

Endnotes:

1. See McPherson (1979) especially Appendix III.

2. The Sahel is not known for having reliable rainfall. The period from the mid-1940s to the late 1960s, however, had been one of higher than average rainfall with no major disruptive droughts (World Bank 1985a:Table 8.1).

3. GOTG 1975.

4. Prior to March, 1973, the dalasi was fixed at D5 = £1. It was then revalued to D4 = £1, and devalued back to D5 = £1 in February 1984. The dalasi was floated in January, 1986. By the end of the ERP (June 1, 1989) the exchange rate was D12.1 = £1. In June 1992, it was D18.2 = £1.

5. Some valuation problems exist. The $114 million represents the amount accrued valued annually. If the amount of arrears reported by the IMF valued in 1986 exchange rates is used it comes to $105 million (or 53% of GDP). In both cases the implication is the same - foreign arrears were large.

6. The factors associated with the decline of the Gambian economy have widely examined (McPherson 1983; USAID 1984:Annex K; World Bank 1985b; and GOTG 1987).

7. From 1965/66 to 1985/86, the government ran a deficit (excluding grants) which averaged 10% of GDP. By contrast, GPMB's profits from groundnut operations averaged only 1.7% of GDP over the same period. Corresponding data for the decade 1965/66 to 1975/76 are 2.1% and 5.5%, respectively.

8. Donors made this point at a UNDP-sponsored conference in November 1984, which, far from generating support for the government's proposed D1.15 billion four-year public investment program, ended with calls for major cuts in it.

9. The memorandum to cabinet on the ERP (August 3rd, 1985) noted:

> The public sector no longer acts as a buffer against adverse climatic factors or exogenous shocks, but, instead has become an additional source of disequilibrium.

10. The lower import duties led to increased revenue because of larger volumes of re-exports and improved compliance.

3

Exchange Rate Reform in The Gambia

Catherine J. McAuliffe and Malcolm F. McPherson

1. Introduction

As part of the ERP, The Gambia floated its exchange rate in January 1986. That action eliminated a price distortion which had created serious economic difficulties from the mid-1970s onward.[1] The float had an immediate positive effect on the economy.

The float also marked a substantial improvement in The Gambia's relations with the donors. They saw it as a demonstration of the government's commitment to structural adjustment. Their subsequent financial support was critical for the success of the ERP.

Now, more than six years after the float and with the ERP having been replaced by the Program for Sustained Development (PSD), exchange rate reform continues to serve its intended purposes. The foreign exchange market has proven to be surprisingly robust.

This chapter examines The Gambia's experience with exchange rate reform. Section 2 discusses the background to the reform. Section 3 considers the consequences of the float for the economy. Section 4 reviews the measures which supported exchange rate reform and the additional measures needed to build on the results achieved so far. Section 5 examines the economic response to the float and recent developments. Section 6 has concluding observations.

2. The Exchange Rate and Economic Performance

a. Background

The Gambia floated the dalasi in response to balance of payments difficulties. From the mid-1970s, imports had increased sharply, domestic exports stagnated, the government's efforts to promote diversification (e.g. into tourism) failed to produce significant additional net flows of foreign exchange, and despite price controls, domestic prices increased rapidly. As a result, foreign reserves declined, the real exchange rate became increasingly overvalued, the current account deficit on the balance of payments rose significantly and from 1979 onward external arrears emerged.

A structural change occurred in the pattern of foreign trade in 1974/75. Table 1 shows that in 1974/75 imports increased by 44.7% as the government began to "promote development" through its first five-year plan.[2] Imports increased by 55.5% in the following year. Corresponding changes in exports were 25.4% and -11%, respectively. Domestic exports continued to perform poorly for the rest of the decade due to drought, producer disincentives, and fluctuations in the world price of groundnuts.[3] For several years, the adverse effects of the imbalance between imports and exports were disguised by the reduction of official reserves and the increase in foreign debt (Table 1).

Table 1: The Gambia, Selected Data

Year	Imports (fob)	Exports (fob)	Current Account Balance 1/	Gross Official Reserves	Total External Debt	Debt/ GDP	Real Domestic Credit	Real Money Supply 2/
	----------Millions of Dalasis----------						Millions of SDRs	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1965/66	-29.1	25.0	-5.8	15.3	7.0	0.07	-4.8	5.6
1966/67	-35.4	29.6	-7.8	21.0	0.8	0.01	-3.2	4.9
1967/68	-37.6	26.2	-15.3	16.2	3.7	0.04	-1.5	6.1
1968/69	-46.7	36.1	-12.9	18.1	7.8	0.07	-0.7	6.3
1969/70	-35.1	32.1	-8.0	25.7	10.3	0.09	-1.1	6.5
1970/71	-42.7	30.2	-19.1	32.9	10.0	0.07	-0.1	6.6
1971/72	-46.2	34.9	-14.9	44.5	12.4	0.08	-9.2	8.3
1972/73	-54.3	33.7	-18.8	44.8	13.2	0.09	1.8	10.6
1973/74	-63.5	67.6	7.2	48.7	16.9	0.08	5.5	13.2
1974/75	-91.9	84.8	-6.6	81.3	21.6	0.10	5.5	17.0
1975/76	-142.9	75.5	-72.7	58.7	26.5	0.10	11.8	19.0
1976/77	-169.1	106.7	-67.8	67.1	56.0	0.16	22.2	24.9
1977/78	-208.1	80.2	-161.1	42.8	91.9	0.27	33.6	29.1
1978/79	-221.0	88.4	-165.3	20.1	87.4	0.21	53.8	30.8
1979/80	-290.4	83.1	-244.2	11.7	118.2	0.28	85.5	34.0
1980/81	-263.4	55.9	-257.4	48.3	153.0	0.37	86.2	35.3
1981/82	-240.6	82.6	-228.7	11.8	224.1	0.49	88.6	36.1
1982/83	-262.1	156.8	-171.3	7.5	508.9	0.96	114.6	45.8
1983/84	-346.7	235.9	-195.1	16.6	778.4	1.30	104.0	38.5
1984/85	-358.7	251.1	-183.5	13.0	767.5	1.14	94.0	45.4
1985/86	-432.6	321.7	-269.6	7.1	1287.5	1.50	91.8	41.7
1986/87	-752.3	526.6	-373.4	100.3	2310.9	2.14	35.6	35.7
1987/88	-760.0	546.8	-294.1	193.8	2332.8	1.86 *	28.4	43.8
1988/89	-902.2	727.4	-257.1	160.8	2486.9	1.65 *	26.4	46.6
1989/90	-1142.5	899.5	-379.8	255.5	2057.8	1.15 *	7.5	47.5
1990/91	-1319.7	1003.6	-362.4	467.3	2204.4	1.07 *	1.1	53.0

1/ These data differ from those reported by IMF, particularly over the period 1977/78 to 1981/82. The IMF data show a lower deficit due to higher estimated tourism receipts.

2/ Money plus Quasi-Money.

* Reflects Paris/London Club rescheduling and other bilateral debt relief.

Sources: Central Bank of The Gambia Quarterly Bulletins, various editions
Estimates of Recurrent Revenue and Expenditures, various editions
GEDRES File and GDATA89 File, Ministry of Finance and Trade
IMF, International Financial Statistics, various editions
International Monetary Fund, SM/92/111, June 2, 1992

The overvaluation of the exchange rate had several causes. There was a growing gap between interest rates in The Gambia and those prevailing on international markets. The Gambia also began to experience significantly higher rates of inflation than its major trading partners. Both effects put downward pressure on the exchange rate.[4]

These developments were reflected in changes in the real exchange rate (Table 2). The nominal and real exchange rate (for exporters) appreciated significantly over the period 1976/77 to 1980/81. The exchange rate was also affected by the expansionary monetary and fiscal policies after 1975/76. The fiscal deficit increased sharply and averaged 8.2% of GDP between 1974/75 and 1984/85. As a result, both credit and money grew rapidly (Table 1) which gave a further impetus to inflation, thereby exaggerating the downward pressure on the real exchange rate. The balance of payments deteriorated because movements in the real exchange rate encouraged imports and discouraged exports and the domestic production of import substitutes.

With the current account deficit on the balance of payments exceeding 40% of GDP in the early 1980s the need for exchange rate action intensified. But, by the time The Gambia devalued the exchange rate in February 1984, it was already too little too late. Foreign exchange reserves had been depleted, external payment arrears were increasing, and a parallel market for foreign exchange was flourishing. The devaluation had little impact on the economy. Confidence in the dalasi continued to erode and the differential between the official and parallel market exchange rates increased to more than 80% by the end of 1985. A major adjustment of the official exchange rate could no longer be avoided.

b. Exchange Rate Reform and the ERP

Many government officials were not convinced that the exchange rate system should be reformed.[5] Much of the resistance derived from the perceived disadvantages of devaluation - higher import costs, cuts in real income, and accelerated inflation. Some resistance, however, was based on the view that The Gambia's problems (like those of most developing countries) had external causes such as drought, declining terms of trade, lower levels of aid, and increases in international interest rates. The idea emerged (particularly in the cabinet, the ministry of economic planning, and the central bank) that there was nothing that could be done locally to rectify the situation; solutions had to be external. One such solution was additional donor support.[6]

Thus, even in mid-1985 with the economy falling apart around them, few government officials saw changes in the exchange rate as part of the solution. The central bank argued that more time was needed to assess the effects of the February 1984 devaluation. This position was curious since central bank staff were better placed

Table 2: The Gambia: Real Exchange Rates for Imports and Exports

YEAR	Average Duties		Nominal Exchange Rate (D/$)	Real Exchange Rate 1/		Nominal Exchange Rate (Index)
	Imports	Exports		Imports 2	Exports 3	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1965/66	0.28	0.03	1.79	0.75	0.48	
1966/67	0.29	0.02	1.79	0.75	0.53	0.77
1967/68	0.24	0.01	2.08	0.75	0.44	0.90
1968/69	0.26	0.02	2.08	0.82	0.70	0.90
1969/70	0.26	0.07	2.08	0.81	0.56	0.90
1970/71	0.27	0.07	2.08	0.71	0.55	0.90
1971/72	0.28	0.08	1.96	0.81	0.58	0.84
1972/73	0.29	0.04	1.54	0.75	0.45	0.66
1973/74	0.21	0.04	1.67	0.79	0.94	0.72
1974/75	0.18	0.05	1.85	1.07	1.30	0.80
1975/76	0.19	0.06	2.22	0.98	0.85	0.96
1976/77	0.22	0.05	2.32	1.00	1.00	1.00
1977/78	0.17	0.09	2.13	1.03	0.59	0.92
1978/79	0.21	0.07	1.88	1.17	0.68	0.81
1979/80	0.19	0.13	1.72	1.23	0.63	0.74
1980/81	0.18	0.02	1.97	1.25	0.44	0.85
1981/82	0.24	0.10	2.39	1.48	0.70	1.03
1982/83	0.24	0.00	2.55	1.55	0.96	1.10
1983/84	0.23	0.15	3.04	1.61	0.96	1.31
1984/85	0.25	0.00	3.71	1.64	1.17	1.60
1985/86	0.28	0.15	4.41	1.42	1.16	1.90
1986/87	0.27	0.00	7.33	2.00	1.59	3.16
1987/88	0.26	0.00	6.89	1.75	1.34	2.97
1988/89	0.31	0.00	7.30	1.52	1.21	3.15
1989/90	0.23	0.00	8.13	1.79	1.21	3.50
1990/91	0.23	0.00	7.94	1.68	1.27	3.42

1/ 1976/77 = 1

2/ One plus the import duty multiplied by the ratio of the dalasi import price index and the domestic price index (GDP deflator, 1976/77=100)

3/ One minus the export duty multiplied by the ratio of the dalasi export price index and the domestic price index (GDP deflator, 1976/77=100)

* Domestic price controls on staple commodities prevented a larger real appreciation.

Sources: Central Bank of The Gambia Quarterly Bulletins, 1965-1991 editions
Central Statistics Department, The Gambia
IMF, International Financial Statistics, various editions
International Monetary Fund, SM/92/111, June 2, 1992
GDATA90.WK1 spreadsheet

than most to know that the devaluation had been ineffective. Between February 1984 and June 1985, when efforts to formulate the ERP began, official reserves had declined further and external debt and payments arrears continued to accumulate. Indeed, the devaluation had the negative effect of demonstrating that the government was not prepared to act decisively with respect to the exchange rate.

In the end, the government had no alternative. A formal devaluation was inevitable. The parallel market had undermined the official exchange rate and the bulk of foreign exchange in the economy was being traded through alternative channels.[7] The advantages of a devaluation, as one element of a policy package, could no longer be ignored. Within the ministry of finance, attention switched from arguing about the relative merits of a devaluation to the appropriate means of achieving it.

The options included a series of programmed devaluations, a foreign exchange auction, or a float. The ineffectiveness of the 1984 devaluation compromised the first option. The loss of confidence in the dalasi had led to widespread disintermediation so that predicting the size of a potentially sustainable devaluation posed serious problems. The parallel exchange rate provided a guide but adverse expectations could keep downward pressure on the dalasi. Few officials believed that, under those circumstances, a pre-announced series of devaluations (as had been attempted in Ghana) would succeed.

A foreign exchange auction was not attractive. No foreign exchange was available to begin the process. Moreover, senior ministry officials lacked confidence in the capacity of the central bank to organize and sustain an auction. They also were concerned that large traders may attempt to corner the market (as had occurred in Sierra Leone).[8]

By contrast, a floating exchange rate system would automatically eliminate currency overvaluation. A float could be initiated without the build-up of official resources. It was relatively simple to operate so weaknesses at the central bank were unlikely to dominate. Finally, it would build on parallel market activity with which Gambians were already familiar.

Thus, for administrative simplicity and its effectiveness in eliminating market distortions, the government decided to float the currency. Accordingly, an interbank market for foreign exchange was introduced on January 20, 1986 when the dalasi was officially allowed to float freely.[9]

3. The Float and its Consequences

The float produced a major real depreciation of the dalasi (Table 2). The demand for foreign exchange from both official and non-official sources declined sharply. As confidence began to rise in the government's commitment to economic reform, additional foreign exchange was supplied to the official market. Large inflows of foreign aid following agreements with the IMF, World Bank, African Development Bank, and bilateral donors in August 1986, also helped stabilize the exchange rate.

Although the operation of the float has not always been smooth, the system has proven to be robust. The comprehensive nature of supporting policies and donor support in the form of debt relief and higher levels of aid have been important in stabilizing the market. Particular attention has been paid to developing a consistent set of monetary and fiscal policies. With these measures, the foreign exchange rate stabilized, the risks of short-term fluctuations declined, and confidence in the domestic economy re-emerged.

An argument against floating exchange rates in developing countries is the absence of well-functioning foreign exchange and financial markets. Since those markets were thin in The Gambia, the government focused on the structure of the interbank market, its operating rules, and measures that would insulate it from potentially disruptive changes in demand and supply conditions. Commercial banks were required to participate in a weekly "fixing session" chaired by the central bank. That session was designed to allow the commercial banks and the central bank to trade among themselves, to consult over market developments, and to determine the weekly "fixing rate," which became the reference point for the valuation of official transactions for the following week.[10]

Although fixed once a week for official transactions, the exchange rate was free to vary at the commercial banks in response to market forces on a daily or even hourly basis. To strengthen the system, the government removed all restrictions on private payments and transfers for current international transactions, established foreign exchange surrender requirements for public enterprises, and set limits on the foreign exchange balances of the commercial banks.[11] The government also obtained technical assistance to improve the management of the central bank and sought continued donor support for fuel grants. By insulating the foreign exchange market from the large irregular demands associated with petroleum imports, the grants were an important stabilizing influence. Finally, the government began to aggressively sell treasury bills as a means of absorbing excess liquidity in the economy.[12]

Despite the precautions, some difficulties had to be overcome. Initially, the commercial banks would not actively compete for foreign exchange. Their managements were antagonistic to the float

and skeptical about its benefits. As the parallel exchange rate moved well beyond the rate at which they were prepared to trade, the banks were quickly cut out of the foreign exchange market. The situation changed in mid-February 1986 after pressure was applied by the ministry of finance. When the banks began to make a market for foreign exchange, the official and parallel rates converged. Table 3 shows exchange movements from January to July 1986. The dalasi depreciated sharply in the first 8 weeks of the float, falling from D7.45/£ in late January to D10/£ in March. By April, the banks began to dominate the foreign exchange market, volumes traded through official channels increased sharply, and the exchange rate stabilized. Between April and July, there was little change in the D/£ rate, and the discount for the dalasi in the parallel market was just 2%.

4. Supporting Policies

The exchange rate change in February 1984 had clearly shown that devaluation alone is ineffective. The ERP did not repeat that mistake and numerous changes were made to ensure that appropriate, timely, complementary policies would be implemented. It was explicitly recognized that the potential for major macroeconomic disturbances had to be minimized.[13]

In order to ensure that the exchange rate adjustment resulted in the necessary expenditure-reducing and expenditure-switching changes, the ERP removed price controls to allow for a complete pass-through of exchange rate changes on domestic prices. In one of the first steps taken, the government decontrolled the retail price of rice and removed all restrictions on rice imports. A flexible pricing system for other key commodities was introduced. The producer price of groundnuts was raised on three occasions during the 1985/86 season. Since January 1986, numerous adjustments were made to other administered prices - petroleum, public utilities, and transport - to reflect developments in costs, including those associated with exchange rate movements. These prices were subsequently decontrolled.

Demand management policies played a critical role in reducing the inflationary effects of the exchange rate depreciation following the float. The main focus was the budget deficit. To contain government expenditures, 20% of civil servants were retrenched, wages and salaries were frozen, and a program to rationalize the operations of the major public enterprises was implemented (see chapter 7). These actions were reinforced by measures to control the expansion of credit in the economy. Limits were set on public sector borrowing and a general ceiling on bank lending was agreed with the IMF. A moratorium on government guarantees and the contracting of new non-concessional medium-term debt were agreed as well (see chapter 14).

Table 3: The Gambia, Commercial Bank and Parallel Exchange Rates January to July, 1986 (Dalasis per Pound)

Date	Bank Rate	Parallel Rate	Official Fixing Rate 1/
(1)	(2)	(3)	(4)
1/17/86	5.00	8.50-9.00	5.00
1/24/86	7.50	9.75-10.00	7.45
1/31/86	7.50	10.25-10.7	7.56
2/7/86	7.50	10.75-11.2	7.61
2/14/86	7.55	7.50-8.50	7.64
2/21/86	7.50-7.55	7.50-11.00	7.64
2/28/86	7.50-9.05	8.25-10.25	7.90
3/7/86	9.00-9.08	9.50-10.50	9.00
3/14/86	10.00	9.75-10.50	10.00
3/21/86	10.00	10.50	10.00
3/28/86	10.00	10.50	10.00
4/4/86	10.00	10.25-10.5	10.00
4/11/86	10.00	10.75	10.10
4/18/86	10.00	10.75	10.10
4/25/86	10.00	10.50-10.8	10.15
5/2/86	10.00	10.50-10.7	10.15
5/9/86	10.50	10.75-10.8	10.60
5/16/86	10.50	11.00	11.00
5/23/86	10.90	11.05	11.00
5/30/86	10.90	11.05	11.00
6/6/86	10.90	11.45	11.00
6/13/86	10.90	11.50	11.00
6/20/86	10.90	11.50	11.10
6/27/86	11.05	11.75	11.10
7/4/86	11.05	11.75	11.45
7/11/86	11.40	11.80	11.45
7/18/86	11.40	11.80	11.25
7/25/86	11.20	11.75	11.25

1/ Set on a weekly basis

Source: Central Bank of The Gambia

These actions substantially reduced the growth of credit which provided a nominal anchor to the economy.[14]

The flexible interest rate policy supported the new exchange rate system. Interest rates were raised administratively in September 1985 but the treasury bill tender introduced in July 1986 left their determination to the market (see chapter 8). These high-yielding dalasi-denominated assets provided an incentive for asset holders to substitute away from foreign exchange, which further reduced the pressure on the exchange rate.

The float played a critical role in re-engaging the donors. Though they had been impressed with the intentions expressed in the ERP (see chapter 2), the donors wanted an explicit demonstration of the government's commitment to economic reform. The float provided such a demonstration. The ensuing generous support (see chapter 16), was instrumental in stabilizing the exchange rate and helping to accentuate the effects of other ERP reforms. Finally, as The Gambia's international credit-worthiness improved, it rescheduled its external debts and begin rationalizing the arrears situation. The reduction in the debt overhang also took pressure off the foreign exchange market.

5. Economic Response and Recent Developments

The exchange rate reform and supporting measures had a positive effect on the economy. There were gains in output and trade, reductions in inflation and external payments arrears, and an increase in foreign reserves. The improvements provided a foundation for sustained growth.

An essential element of the improved economic performance was the significant real depreciation of the dalasi (Table 2). The initial nominal depreciation against the US$ was approximately 40% while the real depreciation was on the order of 30%. Without such a real depreciation, none of the benefits of the float on resource allocation, the structure of demand, the distribution of income, and the balance of payments could have occurred.

The exchange rate reform helped to reintegrate parallel and official market activity. The initial benefit has been increased demand for dalasi-denominated assets. By the time the parallel and official exchange rates converged in mid-1986, most of the exchange market activity was being channelled through the banks.

By reducing excess demand for foreign exchange, the float also enabled the central bank to accumulate reserves. The reabsorption of parallel market activity, the increase in donor support, the reduction in the budget deficit, and the increase in customs revenue following the crackdown on customs fraud (see chapter 12) freed up large amounts of resources. Gross official reserves

increased from SDR 1.3 million (equivalent to 4 days'imports) in mid-1986 to SDR 16.4 million (1.7 months of imports) in mid-1989. Those reserves, together with the normalization of The Gambia's external financial relations and the elimination of external payments arrears (in July 1990) have greatly strengthened the exchange rate system. Unlike the period prior to the ERP, some scope now exists to protect the economy from external shocks which, as demonstrated by the departure of the Mauritanians in April 1989 and the Gulf War in 1991, seem to be inevitable.

The exchange rate has fluctuated since 1986, with periods of both appreciation and depreciation. Notwithstanding the other measures which have been taken to support the float, rigidities emerged which have had adverse consequences. The central bank's ill-advised attempt to re-fix the dalasi created difficulties. For most of 1988/89, there was a de facto fix of the dalasi against the pound sterling. The D/£ exchange rate remained virtually unchanged over the period June 1988 to June 1989. At the same time, the real effective exchange rate appreciated by approximately 13%. To prevent the dalasi from depreciating further, the central bank had withdrawn from the interbank market. Taking their cue from the central bank, the commercial banks did not adjust their buying and selling rates in response to market pressures. Excess demand for foreign exchange produced rationing rather than changes in the exchange rate. The commercial bank "pipeline" re-emerged, parallel market activity increased, and a premium of approximately 10% was being paid for foreign exchange by June 1989.

Unwilling to compete for foreign exchange during 1989, the central bank missed its reserve accumulation target under the IMF program. Furthermore, in order to clear the commercial pipeline the central bank had to sell some of its reserves.

Under pressure from the donors, principally the IMF, the central bank aggressively re-entered the foreign exchange market in early 1990. The main tasks were to clear the commercial pipeline, rebuild official reserves, and restore confidence in the interbank market. The exchange rate responded appropriately. The D/£ exchange rate, for example, depreciated by 10.4% in nominal terms between August and December 1989, and a further 6.4% by April 1990. The real effective exchange rate had depreciated by 10.8% during 1989/90.[15] The parallel market premium was virtually eliminated by mid-September 1989. To enhance competition in the foreign exchange market, the authorities allowed the establishment of foreign exchange bureaus in April 1990.

6. Concluding Observations

Floating the dalasi was crucial to the success of the ERP because it removed a major distortion which had undermined the performance of the Gambian economy. The experience provides several lessons.

First, for the introduction of a flexible exchange rate to succeed, it has to be part of a comprehensive and consistent set of policy changes. In particular, the budget deficit has to be reduced and the rate of growth of money and credit has to decline. Measures to liberalize interest rates and limit the growth of public sector debt are also important.

Second, actions are needed to assure holders of dalasi-denominated financial assets that the new policies will be sustained. Without such assurance, asset-holders will seek other outlets for their resources.

Third, special efforts have to be made to minimize shocks in the foreign exchange market. Reductions in debt service payments (through debt relief) and special arrangements for "large ticket" items (such as fuel) proved to be vital in The Gambia's case.

Fourth, increased competition in the foreign exchange market through direct central bank oversight of the commercial banks and the encouragement of independent foreign exchange dealers were important stabilizing measures.

Fifth, the central bank should regularly and openly operate on both sides of the market. The bank has to establish a presence in the market to deflect any potentially adverse expectational effects that irregular, behind-the-scenes operations might foster.

Sixth, efforts are needed to improve central bank capacity prior to the implementation of the exchange rate reform. Gaps may be filled initially through technical assistance. Nonetheless, additional staff will be needed and will have to be trained.

Finally, The Gambia's experience has shown that the advantages of a fixed exchange rate tend to be overblown. Contrary to some influential opinions,[16] a small, open, developing country can successfully shift to a flexible exchange rate as a means of dealing with its internal and external imbalances.

Endnotes:

1. The Gambian dalasi, created in 1971, was D5=£1 until March 1973. It was then revalued to D4=£1 and remained so until February 1984. It was devalued to D5=£1, the level it retained until the float in January 1986.

2. GOTG 1975. The surge in import demand coincided with a shift in formal sector employment and urbanization. Because the average propensity to import is higher and the average propensity to export is lower among the urban population, the redistribution of population and income from the rural to the urban areas led to a major structural shift in the pattern of merchandise trade (and hence the current account on the balance of payments). The effects of the structural change in demand and supply became increasingly evident as the 1970s progressed.

3. The collapse of groundnut production (relative to historical levels) during the period 1977/78 to 1980/81 when world prices reached unprecedented levels was costly to The Gambia. Over that 5-year period GPMB's purchases averaged 79.2 thousand tonnes per year. The world price averaged $502.4 per tonne. By contrast, for the five years before 1977/78, average purchases had been 127.7 thousand tonnes and the world price was $404 dollars per tonne. The experience led many Gambian officials to attribute the country's subsequent economic difficulties (when groundnut prices fell) to declining terms-of-trade.

4. Uncovered interest parity implies that the exchange rate would increase as the interest rate spread on equivalent financial instruments widened. Letting $e^{\bullet}$ be the expected change in the exchange rate, and i_w be a relevant "world" interest rate (such as the UK treasury bill rate) and let i_g be the comparable Gambian interest rate, then:

$$e^{\bullet} = f(i_g - i_w) \quad f'>0$$

Similarly, purchasing power parity implies:

$$e^{\bullet} = g(dp_w - dp_g) \quad g'<0$$

where dp_w and dp_g are, respectfully, the rate of inflation in rest of the world and The Gambia.

The latent pressures on the exchange rate from both sources were significant. Between 1975 and 1985, the average spread between the bill rates in The Gambia and the UK was 2.7 percentage points. For the same period, consumer prices in The Gambia increased by 377%, while prices increased by 177% in the UK, 100% in the US, 48% in West Germany, 159% in France and 31.2% in Japan. (All data are taken from International Financial Statistics Yearbook 1991).

5. Even as late as April 1984, the minister of finance was not convinced that the exchange rate was a significant factor in The Gambia's economic decline. His views we made known during the 1983 Article IV consultations (IMF SM/83/165 1983:11):

> In discussing exchange rate policy, the Gambian authorities stated that, despite the depressed export prices in the past two years and the slowdown in tourism in 1981/82, developments in The Gambia's external current account balance indicate that their program of reducing absorption through tight credit and fiscal policies has been very effective. Under the circumstances, and in light of the depreciating trend of the real import-weighted exchange rate of the dalasi, they felt that it was reasonable to continue to retain exchange rate policy as an instrument of last resort, to be deployed if detailed studies were to demonstrate convincingly that the exchange rate would be more efficient in achieving government objectives.

That opinion began to change toward the middle of 1984. Contrary to the minister's expectations, the February 1984 devaluation had no significant impact. He commissioned a separate study on exchange rate policy in April 1984 (McPherson 1984). It argued that devaluation should not be seen as a measure of "last resort" but as a positive component in overall economic policy.

6. That reasoning was reflected in the Mid-Term Review of the Second Development Plan (GOTG 1984) prepared by consultants provided by the United Nations Development Program and staff of the ministry of economic planning.

7. The government itself tapped the parallel market on several occasions. One notable example occurred when the central bank convened a meeting of several prominent traders to request them to supply foreign exchange to cover the Hajj in early 1985.

8. The principal reason for rejecting an auction, however, was the fear that Senegal could take advantage of the situation (see chapter 18).

9. Based on data generated since the float. Walsh (1990) has argued that The Gambia did not float its currency but shifted to a sterling peg. His interpretation of these data, however, is selective. The evidence of a "peg" consists of several periods when the dalasi did not change relative to sterling. Those periods emerged as a result of good fortune (in the form of large aid inflows), an explicit agreement between the ministry of finance and the central bank not to let the exchange rate appreciate "too much," and the unwillingness of senior central bank staff and their advisors to use the rate aggressively to gain access to additional

foreign exchange. On the last point, central bank officials frequently tried to argue that holders of foreign exchange would not respond to price signals. They therefore saw no point in "moving the rate" (through central bank purchases). They were proven wrong on every occasion when pressure built up on the rate. None of this characterized the explicit operation of a sterling peg. Finally, when the central bank actually attempted to run a sterling peg (see section 5) the commercial pipeline re-emerged and the parallel market revived.

10. The "fixing rate" was derived from a weighted average of the transactions of the previous week unless transactions occurred during the fixing session, which then set the rate. Despite its inappropriate connotations in a floating exchange rate system, the title "fixing rate" was adopted from the IMF (IMF 1985). It persisted until early 1990 when it was changed to the "customs valuation rate."

11. The commercial banks were required to sell in the interbank market at the end of each week any foreign exchange in excess of established working balances. The export earnings of public enterprises (primarily GPMB) had to be repatriated and sold through the interbank market. All other restrictions on capital movements were removed through the suspension of the relevant provisions of the Exchange Control Act (Cap. 64).

12. As the balance of payments improved, treasury bills have provided a useful means of sterilizing foreign inflows. The T bills have been a highly effective mechanism in helping the government build up its foreign exchange reserves.

13. Professor James Duesenberry was an advisor to the minister of finance in the period immediately before the float. He emphasized the fact that with a floating exchange rate, all macroeconomic disturbances are reflected in the exchange rate. Special measures were needed to minimize those disturbances. The point was well-taken (GOTG 1986:21).

14. The freeze on public sector wages was a key element in reducing the growth of government expenditure. Wage payments represented 31.5% of government current expenditure in 1985/86; they were 14.3% of current expenditure in 1987/88. In real terms, the wage bill declined by 16.5% over the first three years of the ERP.

15. The central bank action had been associated with other policy slippages. For instance, excessive monetary expansion during the first half of 1989/90 led to an increase in inflation. Inflation for 1989/90 was 13.4%; it had been 7.7% during the previous year.

16. Dornbusch (1988:104) stated that:

> Flexible exchange rates may be appropriate for major

currency blocks, but they are certainly a poor idea for an individual developing country.

4

Macroeconomic Reform and Agriculture

Malcolm F. McPherson

1. Introduction[1]

The deterioration in The Gambia's economic performance in the early 1980s, directed attention to the problems of agriculture. It was the country's largest employer and principal source of export revenue. Obvious difficulties were drought and low world prices for groundnuts. The latter was foremost in Gambians minds in 1982/83, for example, when groundnut production recovered sharply from its drought-affected levels of a year earlier but world groundnut prices fell by more than 40%.

Other observers, however, noted more fundamental problems. They acknowledged that drought and fluctuating foreign prices were factors affecting agricultural output and employment, but these were recurrent phenomena with which producers had to deal (and had dealt with). The problems confronting agriculture appeared to be more basic. The sector's dynamism had been sapped by low farm-gate prices, shortages of inputs, an overvalued exchange rate, disintegrating rural infrastructure, and predatory policies by agriculture-related public enterprises.

The decline in food availability in 1983 and 1984 when the local harvest failed and the government could not find adequate foreign exchange to import additional food simply served to intensify the general concern. Thus, by the time the ERP was formulated, agreement existed at all levels that a major effort was needed to revitalize agriculture. Indeed, many believed that the ERP could not succeed unless the performance of agriculture improved dramatically.

In this chapter, we examine the impact of the ERP policies on agriculture. Section 2 reviews the performance of agriculture prior to the ERP. Section 3 considers how the ERP measures were intended to revive the sector. Section 4 discusses how farmers responded to the ERP. Section 5 considers some problems in the immediate future. Section 6 has concluding observations and lessons from the experience.

2. The Performance of Agriculture Prior to the ERP

As shown in Table 1, in the first decade after independence, 1965/66 to 1975/76, Gambian agriculture grew at the same rate as population (2.6% per annum) which was slightly more than half the growth rate of total GDP (4.9% per annum). The average contribution of agriculture to GDP was around 38%. That contribution was sustained largely by high levels of groundnut sales which, due to a string of good seasons, averaged 123 thousand tonnes a year. These volumes together with rising world export prices, contributed to The Gambia's relatively robust balance of payments situation. The current account deficit for the decade averaged 8.3% of GDP which was more than adequately covered by

Table 1: Basic Economic and Agricultural Data, The Gambia

	1965/6-75/6	1975/6-85/86	1985/6-88/9
Real GDP/capita (% per annum)	2.3%	-0.3%	0.6%
Growth in Agriculture (% per annum)	2.6%	1.8%	3.6%
Agriculture growth/capita (% per annum)	0%	-1.2%	0.4%
Agricultural output (% of GDP)	37.8%	29.2%	29.1%
Government Recurrent Expenditures (% GDP)	13.6%	20.7%	29.1%*
Government Budget Deficit (% GDP)	2.6%	13.2%	13.8%*
Development Exp. (% of GDP)	3.9%	12.8%	12.6%
Food Imports (% GDP)	7.1%	15.2%	18.6%
BoP Current Account Deficit (% of GDP)	8.3%	35.9%	25.5%
Groundnut sales ('000 metric tonnes/annum)	122.9	88.5	51.3
Harvested Area ('000 hectares/annum)			
Grain	--	64.7	83.2
Groundnut	--	88.9	78.0
Grain Production ('000 m.tonnes/annum)	--	75.7	103.6
Groundnut Production ('000 m.tonnes/annum)	--	102.1	101.1
Avg. Groundnut Price per tonne (1976/77 dollars)	$556	$491	$287
GPMB's Reserves (change per annum)	+D1.49m	-D1.53m	--
Groundnut Producer Price (current $)	$104.7	$200.1	$226.3
Fertilizer Price (current $ prices)			
Compound	--	$76.7	$156.4
Single Super Phosphate	--	$62.4	$127.3
Rainfall (millimeters per annum)			
Yundum (West Gambia)	1049	870	841
Georgetown	843	708	843
Basse (East Gambia)	919	822	867

* These data are inflated by extraordinary transfers to parastatals of 5.1% of GDP.

Source: Ministry of Finance and Economic Affairs, Macro Policy Analyses Unit

capital inflow. Foreign reserves accumulated and by 1975, they had reached the equivalent of 10 months' of imports. Over the next decade 1975/56 to 1985/86, however, the situation unravelled. Agricultural output per capita declined at an annual rate of 1.2%. Aggregate output per capita declined as well (at an average rate of 0.3% per annum), but at a slower rate than in agriculture. The contribution of agriculture to GDP continued to decline and for the decade as a whole averaged 29%. Since employment had continued to increase in agriculture, the poor growth performance increased the intensity of rural poverty. Moreover, the combined effects of lower groundnut harvests and fluctuating export prices, reduced the contribution of groundnut production to output and the balance of payments. Annual sales averaged 89 thousand tonnes, a decline of 39% from that of the previous decade.

The contribution by agriculture to per capita domestic food supplies fell as well leading to a sharp increase in food imports. These developments in agriculture added to the economy's balance of payments problems which, as shown elsewhere, were already under severe strain (see chapter 3).

Thus, by the mid-1980s, agriculture was in a sorry state. Many factors were involved. Detailed analyses of longer term trends in output and yields pointed to four: heavy taxation, deteriorating public sector capital, chronic underinvestment, and weather.

The taxation resulted from inappropriate output pricing and exchange rate policies. During the 20 years prior to the ERP, the Gambia Produce Marketing Board (GPMB) had fixed the groundnut producer prices at levels which resulted in an average tax on groundnut production at the farm-gate of 25.8%.[2] The overvaluation of the exchange rate from the mid-1970s onward compounded the effects of the tax (see chapter 3). By reducing GPMB's operating margins, the exchange rate kept downward pressure on the groundnut producer price. And by reducing the local costs of imported food, it discouraged farmers from expanding food grain output.

The growth of agriculture was also undermined by the underfunding of recurrent costs (see chapter 13). Recurrent expenditure in agriculture was equivalent to 60% of capital expenditures in 1975, dropped to 27% in 1980, and was only 14% in the year before the ERP. Moreover, since the share of public resources devoted to agriculture was significantly below the sector's contribution to both GDP and employment, there was a persistent transfer of resources from the rural economy to the urban areas.

Changes in the weather were important. Relative to the period 1950 to 1965, average rainfall between 1974 and 1987 declined by 36% in western Gambia and 24% in eastern Gambia. Coupled with the decline in average rainfall was a change in its distribution. Average rainfall in August declined by 50%.[3] At the farm level,

this development led to drought stress in the middle of the cropping season; it limited the extent of water recharge in upland soils which affected the yields of late-season crops; and it reduced the freshwater run-off into the rice fields.

Despite numerous adjustments made by farmers, the changing rainfall pattern severely affected food, cash crop, and livestock production. This was reflected in production. The grain equivalent of agricultural output in the three good rainfall years (1974-1976) was 233 thousand tonnes. For the three poor years (1979-1981), it was only 172 thousand tonnes. The adverse trends in rainfall were accentuated by declining soil fertility suggesting that farmers themselves would not or could not make the necessary investments in fertility maintenance.[4]

3. Agriculture and the ERP

Many of the policy measures included in the ERP, such as exchange rate reform, civil service and parastatal reform, changes in monetary and fiscal policies, the reorientation of public investment, and the rationalization of the country's external debt were expected to contribute to the revitalization of agriculture. Improvements in agriculture, in turn, were expected to reinforce the effects of these measures.

The ERP sought to influence agriculture at both the macro and micro levels. Traditional approaches to agricultural development had tended to concentrate on farm and village level improvements. However, in the early 1980s, agricultural specialists began to highlight a point which Gambian experience had confirmed, that inappropriate macro policies can adversely affect agricultural performance.[5] The Rural Development Project I (RDP), implemented between 1976 and 1982, is illustrative. The project was large financially and geographically, but its impact at the farm level was undermined by the overvalued exchange rate, low producer prices, and an acute recurrent cost problem.[6] A government commission of enquiry revealed that mismanagement and corruption had adverse effects as well.[7]

The macro level policies were designed to improve incentives through relative and absolute price changes. This was achieved, initially, by the exchange rate reform and the decontrol of prices. Devaluation combined with the liberalization of the grain market substantially raised the local price of rice and coarse grain. Further impetus was provided when the government subsidized the price of groundnuts (see chapter 5). The resulting changes in relative and absolute prices raised farm incomes and markedly increased the returns to labor.[8] Since urban wages had been fixed under the ERP, the rural-urban terms of trade improved considerably.

Other policy changes were also intended to help farmers. Higher levels of efficiency in the civil service would potentially free up resources for development activities. Of direct concern in this regard was the ministry of agriculture, which had become overstaffed and largely dysfunctional. Parastatal reform was designed to improve the efficiency of the state-owned organizations associated with agriculture, the GPMB, GCU, and LMB. Farmers were expected to benefit from higher returns for their output and cheaper inputs.

Monetary policy changes which affected agriculture were the decontrol of interest rates and tighter credit controls. While higher interest rates adversely affected those who had preferential access to credit, it contributed to an improvement in equity. Over the medium term, the interest rate reforms were intended to reduce the fragmentation of the credit market and improve the access to credit of all borrowers (see chapter 9).[9] Fiscal reform, especially the reduction in the public sector deficit, was intended to supplement monetary actions so as to permanently lower the rate of inflation. Farmers would benefit through reductions in their costs.

Farmers' costs were also meant to decline as the government rehabilitated the social infrastructure (roads, ferries, telecommunications, the port, and airport). Transport cost pressures would moderate and the ease of providing information would improve. Finally, by rationalizing its external debt, The Gambia would re-establish its international credibility. The resulting increase in commodity aid, technical assistance, and financial support would ease the burden of structural adjustment on all Gambians, farmers and nonfarmers alike.[10]

All of these measures produced favorable outcomes as agricultural output began to increase. Indeed, the ERP resulted in the first general increase in per capita agricultural output since independence. The improvements have been maintained under the Program for Sustained Development (see chapter 19).

Notwithstanding these positive developments, the recovery in agriculture has depended heavily on the improvement in weather conditions. Fundamental problems remain which cast serious doubt on the sector's future prospects. In the following sections, we discuss the responses by farmers to the ERP and the types of constraints and opportunities they face as they attempt to raise agricultural output on a sustainable basis over the longer term.

4. How Farmers Responded to the ERP

At the time the ERP was formulated, Gambian farmers were experiencing a period of intense uncertainty. Several factors were a concern - food security, government action, changes in regional

markets, and constraints on local farming systems.

a. Food Security

Food security concerns were heightened by food shortages during the period 1983 to 1985. The 1983 crop season was disastrous for many rural families. After a food grain harvest of 105 thousand tonnes in 1982, the 1983 harvest of 70 thousand tonnes was a major setback. Food aid and official imports provided a buffer but the poor grain harvest in 1984 (86 thousand tonnes) created serious problems in early 1985, especially when the government was unable to purchase additional food supplies because of a shortage of foreign exchange.

The crop failure and the government's inability to make up the shortfall made a deep impression on farmers. Many of them adopted a "survival strategy" by reallocating land away from groundnuts to cereals.[11] A similar reallocation had occurred after the 1971-73 drought for food security purposes.[12] When the weather improved, millet area declined because market opportunities were limited. In the mid-1980s, however, the situation was different. The area of cereals harvested increased from 60 thousand hectares in 1984/85 to 87 thousand hectares in 1985/86. The shift was entirely at the expense of groundnuts, the area of which fell from 91 thousand hectares to 59 thousand hectares.

With the groundnut subsidy in 1986/87, the returns to groundnuts increased more than the returns to cereals, and the area planted to groundnuts increased. By 1987/88 it had recovered to pre-ERP levels. It has not increased further. Coarse grain area, on the other hand, has expanded to levels approximately 50% higher than prior to the ERP.

b. Government Action

Despite the relative coherent and comprehensive program of policy reform intended to support agriculture under the ERP, government actions have provided mixed signals to farmers. These have a variety of sources. The ERP has taken several years to implement. Administrative measures, such as the civil service wage freeze, the exchange rate reform, and price decontrol were implemented early in the program. Many institutional changes, which were intended to improve efficiency have been delayed.

The changes which have occurred such as the reduction of GPMBs role in groundnut marketing, improvements in the management of the Gambia Co-operatives Union (GCU), and the re-organization of the ministry of agriculture have proven to be time-consuming, costly, highly political, and only marginally useful. Six years after the initiation of the ERP, the formal rural credit system run by the GCU is defunct and disruptive (see chapter 9) and the ministry of agriculture has yet to assume some purposeful direction.

The resulting disarray has been compounded by other administrative inconsistencies. An example is fertilizer distribution. Late delivery of imports, liquidation prices for old stock, and free distribution by some organizations have undermined efforts to privatize the activity. Lowering the price groundnuts after such a dramatic increase in 1986, simply deepened producers' mistrust of the GPMB[13] and cast doubt on the government's capacity to maintain its commitment to other policy changes. Efforts to liberalize the credit system have been compromised by continued subsidies to selected groups. Overall, farmers have developed a deep-seated cynicism about government-supported activities in agriculture.

c. Market Stimulus for Millet Production

With price decontrol and devaluation, the prices of all agricultural commodities has risen. For example, since 1986 local prices for coarse grains, meat, and groundnut hay have been high both in relative and absolute terms.

Millet production in particular has become especially attractive. As noted above, farmers have been concerned about food security. Millet is a useful way to increase the degree of cereal self-sufficiency so some effort has been devoted to increasing its supply. On the demand side, there has been an expanding market for coarse grains in Senegal (and other parts of the Western Sahel) due to population pressure, the high relative cost of rice production, and calorie substitution in consumption as per capita real incomes decline. In terms of improved resource allocation, millet production represented a rational reallocation of resources away from maize which, relative to millet, has higher cash requirements, especially for fertilizer. Finally, millet is better adapted to the decline in rainfall in the Western Sahel than either maize or sorghum.

The shift to coarse grains out of groundnuts appears to represent a basic shift in Gambian agriculture. For instance, survey data show that farmers are now applying relatively large amounts of fertilizer to millet. As recently as 1982, that practice was rare.[14]

d. Pressures on Gambian Farming Systems

In order to respond to the higher market prices for groundnuts and cereals, Gambian farmers have faced the questions of whether to use additional land or to cultivate their existing land more intensively. At the aggregate level, there is little additional land.[15] Since 1970, the area planted to upland crops has grown from approximately 100 thousand to 170 thousand hectares and has stabilized. That increase has been due primarily to a shorter fallow period. At the village level, studies have shown that the land pressure is often far more acute with annual cropping on 70 to 90% of all crop land.[16]

Given the current pattern of cash crop, food grain, and livestock production in The Gambia, the "land frontier" has effectively closed. Without inputs such as fertilizer, farmers continue to shorten the rotation at great risk. With manpower depleted through outmigration, the destumping of distant fallow fields to permit rapid rainy season cultivation is too difficult for households consisting of predominantly older men, women, and young children.[17]

In the absence of additional land, output can only be increased on a sustained basis through higher levels of productivity. For many years, the Gambian Extension Service has been promoting the use of early maturing varieties of groundnuts and cereals, fertilizer, and methods to improve crop stands (early planting, improved seed, seed dressing, thinning, and timely weeding). Nevertheless, agriculture on the low-organic matter, sandy-loam soils of the semi-arid tropics is difficult to intensify. Applying fertilizer and planting improved varieties have little effect unless there is careful husbandry of the soil itself. Organic matter management, critical to the nutrient cycling and the water holding capacities of Gambian soils, is indispensable to the development of more productive agricultural systems.

Improved technologies are available, but farmers have been highly selective in what they adopt. According to the 1990 National Agricultural Sample Survey,[18] crop planting dates were widely dispersed, seed treatment was low (7% of area for coarse grains, 28% for groundnuts, and 1% for upland and swamp rice), and virtually no improved seed was used (2% of area for coarse grains, 1% for groundnuts, and 0% for upland and swamp rice). The majority of farmers, however, thinned their cereal crops (67% of the area for coarse grains, 11% for groundnuts, and 27% for upland and swamp rice), used fertilizer/manure on approximately half the cropped area, and employed animal traction in most of the upland fields for planting and weeding (95% of the area for coarse grains and groundnuts, and 4% for upland and swamp rice).

There are several explanations for the uneven rate of adoption of improved technologies. Some technologies are not profitable. For example, in the case of early millet the on-farm response of improved technologies was low.[19] Other technologies are not adopted because farmers lack capital or because their preoccupation with food security reduces their willingness to take additional risks. Another reason for low adoption rates is that prior to the ERP, Gambian agriculture experienced considerable decapitalization.[20] Working capital constraints have been severe. The smaller area sown to a fertilizer-demanding crop like maize once fertilizer subsidies were eliminated is only one of several indications of this point.[21]

Finally, efforts to intensify agriculture have been held back by inattention to the role of women in agriculture in general and lowland cropping in particular. Women farmers have few capital

resources and their access to land is tenuous, especially if the prospect of promising male-oriented activity exists.[22] Recent research on inland valley rice, the major agricultural enterprise for women, has shown that several stand-alone technologies such as improved varieties, animal traction for land preparation, seeding and weeding, and the use of fertilizer and herbicides, can significantly improve yields. Under current circumstances in Gambian agriculture, women lack the resources to take advantage of these technologies.

One technology that has been increasingly adopted by Gambian farmers, despite its significant cost, is the use of animal traction. High population growth rates and the departure of young rural workers to urban centers has resulted in the anomalous situation of a large increase in total population and an on-farm labor pool which is too small to support intensive production systems. That constraint together with the demands of the shorter growing season associated with changes in rainfall patterns has led farmers to invest in traction. In the decade prior to the ERP the number of donkeys and horses used for traction increased at the rate of 25% per annum.[23] Their numbers have stabilized at about 45 thousand since then, partly due to the heavy replacement requirements (put at 25% annually) as a result of high mortality rates. Additional investment has been directed into oxen.[24]

5. The Immediate Future

Gambian farming systems are currently in a period of transition. Without more agricultural labor (to destump the uplands and weed the lowlands) and capital (for fertilizer, improved seed, implements and traction), the systems can neither expand markedly nor intensify. Millet, therefore, has become the crop of choice. Where fallowing is less frequent, millet can be grown and provides adequate output, especially when manure is applied. Compared to groundnuts, it requires fewer inputs (the seed costs, for example are negligible) and less labor (due to the ease of harvesting).

Some new enterprises have promise. Improved varieties and modified cropping systems for crops such as cassava, sweet potato, cowpea, resistant cultivars of citrus, and mango provide alternative income sources. Seasonal sheep fattening and localized milk production provide additional dimensions to farmers' livestock activities. The production of horticulture for export has limited possibilities for expansion.[25]

The potential value of these and other improvements raises the issue of how farmers might take advantage of them. Due to price liberalization under the ERP, input prices have increased sharply. Both donors and the government have difficulty seeing beyond subsidized credit as a solution. Experience has shown, in fact, that when farmers consider inputs to be essential, they will

acquire them even when credit is priced at market-clearing rates. The expansion of animal traction is a case in point.

However, a special case might be made for the donors and the government to take measures to increase the supply of fertilizer. For private importers, fertilizer is unprofitable. It is costly to transport, difficult to store, its demand is highly seasonal, it usually has to be sold on credit, and has a high opportunity cost relative to traditional import items - rice, flour, tomato paste, and sugar. Should the public sector begin such a program, special measures would be needed to ensure that its costs are transparent and the agencies involved held accountable. These were absent from earlier programs and major abuses were common at considerable cost to farmers in particular and agriculture in particular.

6. Concluding Observations and Lessons

In The Gambia, structural adjustment has become a crucial first step in economic recovery. Sustaining the recovery, however, requires the revitalization of agriculture. That is not an easy task. Local farming systems are under pressure as farmers shift from extensive to intensive methods of production. The physical and biological constraints are severe, made worse by the financial difficulties farmers have experienced over recent years. These difficulties have been compounded by the inability of the public sector to become constructively re-engaged in agricultural development.

At the macro level the ERP policies removed distortions in prices and exchange rates and farmers now receive higher net returns for their produce. These changes helped to reverse the decline in per capita incomes. Nonetheless, the anticipated revitalization of agriculture has not occurred. Indeed, the Gambian experience shows that macro policy changes can at best only create the conditions for an expansion in agricultural output. For sustained agricultural growth, improvements in farm level productivity are essential. In The Gambia, that will require special efforts in at least four areas: the organization of production, access to inputs, marketing of output, and economic policy.

Although some variation exists, Gambian farming systems are in a transition phase from extensive to intensive farming practices. Innovations in technology have to be specialized. Labor-intensive technologies and those that further degrade the soil have to be avoided. Some interventions, which can have long term effects are immediately possible. For instance, the use of improved quality seed would raise yields and lower the costs of groundnut production.[26] Improvements in equine health would have an immediate pay-off, as would reductions in the handling and crop storage losses.

Providing women with access to fertilizer, credit, and technical assistance has been limited. Attempts to intensify agricultural production will fail unless substantive changes in these areas are made.[27]

Changes in relative prices favoring millet and livestock over the last several years indicate that improved farming systems are needed which focus on cereals and fodder rather than groundnuts. In The Gambia, the upland soils and low rainfall are conducive to millet production and fodder crops, while the riverine ecology in the east of the country has fresh water and pasture available year-round.

Despite grudging adjustment efforts and numerous delays, the dominance of state-owned organizations in agricultural marketing and the distortions they have created are being eliminated. So far, the restructuring which has occurred has not provided The Gambia with a viable set of institutions which market, process, and finance agricultural output.

Farmers have avoided some of the problems by marketing their output through alternative channels. Although a solution may ultimately be found, the outcome is unsatisfactory - inefficient public enterprises continue to operate while farmers devote additional effort finding low-cost outlets for their produce.

If the government remains committed to the ERP policies, many of the beneficial effects of macroeconomic policy changes will persist. So far, however, it has been donor pressure which has kept the reform effort on track. Long term development can only be sustained if responsibility for ensuring that major distortions do not reemerge is shifted to the government. Two areas which require government attention and which have seriously compromised the growth of agriculture have been the persistent underfunding of recurrent costs (see chapter 13) and corruption.[28] They are a litmus test of the government's commitment to agricultural revitalization.

Improved macroeconomic policies are a start. Future agricultural growth and development will require sustained improvements in productivity. In The Gambia, that farm-level challenge has yet to be met.

Endnotes:

1. This paper draws freely from McPherson and Posner 1991.

2. Based on data in World Bank 1975:20-21 and Haughton 1986:124.

3. Wright 1988.

4. OTA 1988.

5. Timmer, Falcon and Pearson 1983.

6. RDP 1979.

7. GOTG 1981.

8. McPherson and Posner 1991:Table 2.

9. Shipton 1987; 1991.

10. Radelet 1990.

11. World Bank 1986:9-10.

12. CRED 1977:5-7,49-51.

13. GPMB bought only two thousand tonnes of groundnuts in 1992.

14. The surveys were conducted in 1981 and 1982 (Haydu et al. 1986). Five years later 70-85% of the millet fields were being fertilized in several villages with limited fallow lands (Posner and Jallow 1987). Farmers who could have just as easily applied fertilizer to their groundnuts, found it was more rewarding to use it on millet (Mills, Kabay, and Boughton, 1988).

15. In 1948, 58% of The Gambia was covered by forest; by 1968 forest cover was 8% (Mann 1975). There has been only minimal clearing of the primary forest since then (Posner and Gilbert 1989a and 1989b).

16. Mills, Kabay and Boughton 1988; DOA 1990:219.

17. Another indication of the shortage of good agricultural land is the recent absence of "strange farmers". In the mid-1970s there were on the order of 12,000 to 17,000 strange farmers in The Gambia (World Bank 1975:16; Dunsmore et al. 1976:286-287). In 1990, strange farmers cultivated only 1% of the area under coarse grains, 4% under groundnuts, and 6% under swamp and upland rice (NADC, 1991:Table 8.3). This represents a total of only 5 thousand hectares involving fewer than 2,000 individuals.

18. NADC 1991:Section 8.

19. Diallo, O'Neil, and Manneh 1988.

20. To illustrate, a 1982 study of 46 "production-consumption units" from 9 villages showed that the average value of fixed capital for each farming unit had declined substantially (Haydu et al., 1986, Table IV-13). Parenthetically, one justification for the large groundnut subsidy was that it would provide badly needed working capital for farmers (see chapter 5).

21. Farm level data have always shown that farmers spend only a small proportion (significantly less than 10%) of their cash on inputs (Dunsmore et al., 1976:Table VI.4; von Braun, Peutz and Webb, 1989:Tables 23 and 32). Even then, studies in 1986 showed that, 50% of farmers did not have enough capital to buy more seed nuts to increase their groundnut area (Posner and Jallow 1987:28).

22. Dey 1982; Bastone 1988; von Braun, Peutz, and Webb 1989:Table 18; and NADC 1991, Section 6.

23. Sumberg and Gilbert 1988:6.

24. Their number increased from 22 thousand to 31 thousand between 1987 and 1989 (NADC 1991:Table 4.2).

25. The main constraints on agro-industrial expansion are capital, energy, management, transport costs, and disease. Some niche producers are doing relatively well. They have all had large amounts of support from the government in the form of subsidies and tax breaks (Gray et al. 1992). The social value of these activities is debatable. Their longer term impact on agriculture and local employment is still unclear.

26. DOA 1990:31.

27. Gladwin and McMillan 1989.

28. McPherson 1979; World Bank 1986; GOTG 1975, 1981; Gray et al. 1992.

5

The Groundnut Sector

Christine Jones and Steven C. Radelet

1. Introduction

Groundnuts have long been the backbone of the Gambian economy. Up to the latter part of the 1970s, groundnut production and marketing contributed over 20% to GDP, employed the majority of the workforce, and accounted for 90% of export earnings. But during the late 1970s and early 1980s, the groundnut sector deteriorated markedly. In many ways, the decline of the Gambian economy in the early 1980s was directly related to the collapse of the groundnut sector.

This chapter recounts the factors that led to the deterioration of the groundnut sector, and analyzes three sets of reforms which the government introduced under the ERP. First, in 1986/87 at the insistence of the IMF the government raised the farmgate price of groundnuts to 50% above the export parity price. The high price required a subsidy equivalent to 8% of GDP for the Gambia Produce Marketing Board (GPMB), the government agency which until 1989 held a monopoly on groundnut trading, processing, and marketing. The subsidy was reduced in subsequent years and eliminated in 1988/89. Second, the government introduced a series of measures aimed at reforming the groundnut trading and marketing system. Third, in 1990 the government began to dismantle the GPMB's monopoly on groundnut processing, by allowing private businesses to process and export groundnuts.

2. The Performance of the Groundnut Sector, 1975-85

In the mid and late 1970s, the world price of groundnuts more than doubled from its level of the early 1970s. GPMB profits soared, and by 1977/78 its reserves reached D106 million (equivalent to 30% of GDP), triple the level of only five years earlier. Largely as a result of groundnut prices, the economy was booming in the mid-1970s. But within five years, GPMB's reserves had disappeared and it was in debt to the central bank. The entire groundnut sector essentially collapsed along with the GPMB - groundnut production was 45% lower in 1985 than it had been in 1976, and groundnut exports had fallen 60%.

Many factors contributed to the decline of the groundnut sector. Prolonged drought and parasite infestation severely undermined production. At the same time, world prices fell sharply, almost to the level of the early 1970s. GPMB attempted to maintain nominal producer prices at their previous levels, and in several years actually increased them. Gambian prices remained 30% or more above the price in neighboring Senegal, inducing imports of Senegalese groundnuts and adding to GPMB's losses. Only in 1983 did the GPMB finally lower farmgate prices - a year in which world prices rebounded somewhat. But at that point, the organization was already bankrupt.

GPMB's financial difficulties stemmed only partially from the fall in world prices. The overvalued exchange rate seriously affected its dalasi revenue base. Furthermore, GPMB provided generous subsidies on rice, fertilizer, and groundnut oil. It invested in a series of enterprises unrelated to groundnuts, suffering financial losses. Moreover, the government extracted more than D40 million out of GPMB's reserves in the late 1970s to cover mounting government budget deficits. By 1984, GPMB's reserves had disappeared and it owed the central bank D110 million.

The groundnut sector was further harmed by the performance of the second major agricultural parastatal, the Gambia Cooperatives Union (GCU). The GCU purchases groundnuts from farmers for delivery to the GPMB and provides farmers with fertilizer, seed, and credit. But its inadequate storage facilities led to crop losses as high as 30% in the late 1970s and early 1980s. Moreover, the GCU often failed to provide inputs on a timely basis. In 1985, an estimated 19,000 hectares (21% of the area eventually harvested) were prepared for groundnut cultivation but could not be planted due to late delivery of seeds.[1]

The collapse of the groundnut sector fed directly into The Gambia's balance of payments crisis of the mid-1980s. Nominal dollar exports in 1984/85 were 30% less than in 1979/80 - almost completely due to groundnuts. The fall in export receipts was a major factor in the erosion of the government's foreign exchange reserves and the rapid escalation in debt service arrears. The crisis intensified as the country fell into arrears with the IMF, and the Fund threatened to declare The Gambia ineligible for further drawings (see chapter 2).

3. The Groundnut Subsidy

The IMF missions in 1985 and 1986 quickly focused on the groundnut sector. Their thinking on the subject was beguilingly simple. To increase official foreign exchange receipts, GPMB would have to raise its producer prices, in order to attract more nuts and maximize its export sales. Moreover, since Senegal had dramatically raised its prices in 1985, the GPMB would have to raise prices nearly as much to ensure that Gambian nuts would not flow across the border with a consequent loss of foreign exchange earnings to the GPMB. The Fund had a direct interest in The Gambia maximizing its official export receipts: the foreign exchange would be used by The Gambia to pay its arrears to the Fund. Thus, in 1986, the Fund proposed that the GPMB raise the producer price to D1800/tonne, three times the 1984 price and 50% above the export parity price.[2]

A price so much higher than the world price required a massive subsidy - D83 million or the equivalent of 8% of GDP. For the IMF to advocate such a large subsidy to a parastatal was unprecedented.

The Fund envisioned that the subsidy would be fully covered by donor support. But as the issue was debated in early 1986, there were no significant donor commitments to support the ERP or the groundnut subsidy.

Minister of Finance Sisay felt that the subsidy advocated by the Fund was too large, and that it could not be fully financed or sustained over time. Instead, he proposed a price of D1400/tonne (a 17% subsidy), which would still provide farmers a significant increase in the farmgate price but would not reach the level of the Senegalese price. Sisay reasoned that an outflow of groundnuts to Senegal would be advantageous: farmers would be paid in CFA francs - a fully convertible currency - and because Senegalese was also subsidizing groundnuts, farmers would be paid much more foreign exchange than GPMB would receive for its exports on the world market. He believed the government could rely on the newly established interbank market for foreign exchange to induce farmers to convert the CFA francs to dalasis. In this way, the economy could earn additional foreign exchange without such a large subsidy. The strategy entailed obvious risks, as the government had only just introduced the interbank market, and it was only beginning to function smoothly. Nevertheless, Sisay felt it was less risky than the huge, still unfinanced, subsidy.

Election year politics became an important piece of the puzzle. There was obvious political appeal in providing farmers with a huge subsidy, approved by the IMF, in the months just before presidential and parliamentary elections, especially while the government was introducing a long list of economic reforms. The president decided to follow the Fund's advice, and the farmgate price was raised to D1800/tonne.

Fortunately, financing the subsidy did not become a major problem. In mid-1986, donors began to provide financial support to the ERP (see chapter 16). Foreign aid flows - including structural adjustment loans from the World Bank, counterpart funds from fuel grants from the United Kingdom and the Netherlands, commodity stabilization grants from the European Community (which were committed before the ERP), and (later) grants from the United States, all helped to finance the groundnut subsidy. As a result, the government was able to fully finance its large budget deficit without borrowing from the central bank - indeed, the government reduced its deficit position with the central bank during 1986/87. In effect, much of this aid was transferred directly to Gambian farmers - some of the poorest Gambians who had been most severely affected by the economic decline of the early 1980s.

The high price, together with the end of the drought, led to a groundnut boom in 1986/87. Groundnut production jumped 45% from the depressed level of 1985/86, and GPMB's purchases increased 35%. Gross farm receipts from groundnuts more than doubled in nominal terms over the previous year, providing farmers with a much-needed

boost in income. Even with the high Gambian price, some farmers sold their groundnuts in Senegal, mainly to avoid selling through the GCU (either to evade loan repayment, or because GCU sometimes paid with promissory chits instead of cash). Nevertheless, groundnut export receipts grew 15%, despite a softening in world prices.

Although the subsidy worked well in 1986/87, it was clear that it could not be sustained over time. The farmgate price had to be reduced in 1987/88 - the only question was by how much. The Fund took the exact opposite stance of its position the year before, arguing that a large subsidy could not be financed, and that in the long run the farmgate price should approximate the world price. It further argued that a lower price would induce exports to Senegal, which would reduce the budget subsidy, and, through interbank market for foreign exchange, which by then was functioning well, increase total foreign exchange earnings. In short, the Fund adopted the position that Minister Sisay had taken in the previous year. It advocated a price of D1300/tonne, a 27% decline from the 1986/87 price.

The government saw things differently. While recognizing the need for a lower price, it argued that given that the price had already been raised to D1800/tonne, it would be unfair and confusing to farmers to lower the price as much as the Fund suggested. With their position bolstered by commitments from several donors for continuing financial support, the government pushed for a price of D1500/tonne.

The World Bank also wanted the government to reduce the subsidy. In fact, one of the conditions for disbursement of the first World Bank structural adjustment loan was a government commitment to completely eliminate the subsidy by 1988/89. But the Bank agreed with the government that the IMF's proposed 27% decline was too sharp. After prolonged discussions, the government's position prevailed.

Despite the reduction in the farmgate price, groundnut production grew an additional 9% in 1987/88. However, GPMB purchases fell about 7%, indicating that a significant amount of groundnuts were exported by farmers directly to Senegal. The cross-border sales led to a dramatic increase in central bank purchases of CFA francs during the harvest season.

In 1988/89, there was a further reduction in the producer price to D1100/tonne. This completely eliminated the subsidy as required by the World Bank. Production fell 18%. Even more striking, GPMB purchases fell 60%, indicating that large quantities of groundnuts were sold in Senegal. The following year, buoyed by an increase in world prices, GPMB raised the producer price to D1650/tonne, and, without a subsidy, was able to post a financial surplus for only the second time since 1977/78.

There were several beneficial aspects to the subsidy. Most importantly, it provided a much-needed large and immediate boost to rural incomes. Real GDP in agriculture grew 20% between 1985 and 1988, largely as a result of the end of the drought and the groundnut subsidy. The results of the model simulations reported in chapter 17 suggest the subsidy led to a 7% increase in real rural wages. Groundnut production had temporarily became an attractive employment opportunity for displaced urban workers, particularly civil servants who had been retrenched in early 1986. The subsidy, therefore, was an important means of supporting the poorest Gambians during the period of adjustment.

Moreover, the subsidy was critical to the political acceptance of the ERP, helping the ruling People's Progressive Party (PPP) retain its rural support during the 1987 election (see chapter 18). Finally, the subsidy forced the GPMB to begin to rationalize its finances, both because its costs began to be more closely scrutinized by the ministry of finance and the IMF, and because the budget subsidy obviated the need for the GPMB to rely on central bank financing for its operations.

The major difficulty created by the subsidy over time was the erratic producer price observed by farmers. The dramatic increase, then fall, then increase in prices over four years caused a great deal of confusion, which in all likelihood adversely affected planting decisions, with consequent efficiency losses. Farmer confidence in the government's role in supporting agricultural suffered as well.[3] In retrospect, a constant nominal price of D1400/tonne over the period (as originally advocated by Minister Sisay) would have been preferable to the sharp oscillations in the producer price which actually took place.

4. The Groundnut Marketing System

The subsidy was not the only major policy change of the ERP to directly effect the groundnut sector. Beginning in 1986, the government took several steps to decontrol groundnut marketing and processing, with the objective of increasing competition and efficiency in these activities.

Unlike many marketing boards in Africa, the GPMB did not actually buy groundnuts at the farm level. Rather, it licensed traders to buy on its behalf and paid them buying and freight allowances. Thus, its marketing costs were limited to the total allowances which it paid on a per tonne delivered basis. In practice, the risks were borne by the traders. Traders who could not make a profit on the basis of the allowance paid by the GPMB would go out of business. If the allowances were set too low, traders would have no incentive to enter the market, raising the likelihood of cross-border sales and reducing the amount of groundnuts delivered to the GPMB.

In practice, the system worked somewhat differently because of the GCU. The GPMB licensed two categories of buying agents: cooperatives and private traders. The GCU was the apex organization of the 82 Cooperative Produce and Marketing Societies which were directly responsible for purchasing groundnuts. It was the only public enterprise authorized to buy on behalf of the GPMB. Although the GCU was paid a higher allowance than private traders, it operated at a loss which was financed largely by loans from the state-owned Gambia Commercial and Development Bank (GCDB). Thus, the GPMB could run the risk of squeezing the marketing margins, knowing that the losses would be covered by the banking system. With no pressure to contain its costs, the GCU expanded its operations and crowded out some of the private traders. GCU's market share doubled between 1974/5 and 1984/5, when it reached 80%.

Pressure to reform the groundnut marketing system came from several quarters. First, there was a need for the GPMB to minimize its financial losses, in order to limit the subsidy from the by government. The allowance system enabled the GPMB to place upper bounds on a major component of its marketing costs. Second, there was pressure from donors, the government, and banking system to reduce the GCU's financial losses. Third, the donor community had a strong interest in promoting private sector development. The competitive advantages accorded to the GCU, combined with the erosion of the real value of marketing allowances, had driven many private traders out of business. This had seriously distorted the allocation of resources in groundnut marketing.

USAID financed a study in 1986 to examine how to improve the efficiency of the marketing system.[4] A survey was carried out to compare trader's costs (both private traders and the cooperatives) with the allowances paid by GPMB. Private trader's marketing costs were estimated to average about D 61 per tonne, which was about 10% more than the 1985/86 GPMB marketing allowance of D 55 per tonne. In addition to the buying allowance, traders were also paid a freight allowance to cover the cost of transporting groundnuts from their buying stations to the nearest GPMB depot. The freight allowance was estimated to be about half of what was required for a private trader to break even, given the low volumes purchased in 1985/86.

Traders found it particularly difficult to show a profit in 1985/86. Since the allowances were paid on a per tonne basis, the greater the volume purchased, the larger the potential profits, as fixed costs were spread over higher volumes. The total volume purchased in 1985/86 was one of the poorest on record, leading to large losses. Furthermore, it was becoming increasingly difficult to break even, as the allowance had eroded by about one-third in real terms between 1981/82 and 1985/86. The result was that the number of private traders decreased each year as the old traders retired, with more and more locations served only by the

cooperatives.

The decline in the number of private traders translated into higher overall marketing costs. It was estimated that GCU's marketing costs were about 60% greater than those of private traders and about 60% more than the allowance it received from the GPMB. As a result, GCU was not in a position to pay back the crop purchase credit it received from the GCDB. Private traders, however, were strictly monitored by the local banks. Credit was advanced to private traders to cover two weeks; only when the trader delivered the groundnuts to the depot was he then able to replenish his purchasing fund. As a result of these arrangements, the increase in GCU's market share over time led to an increase in average marketing costs without any corresponding gain in efficiency.

GCU had several advantages over private traders. In principle, private traders and GCU were required to pay farmers the official price, so they were not able to compete on that basis. However, in many cases, it was more advantageous for farmers to sell to the coops, because that ensured their access to subsidized credit and fertilizer. From 1981 through 1985, GCU had a monopoly on the distribution of fertilizer. It was also the sole distributor of seednuts (in the years that the government provided them). Furthermore, GCU provided inputs (many of which were supplied by donor agencies) to coop members on concessional terms. There was little pressure from either the government or the donors to recover their loans.

Under these conditions, it is perhaps surprising that private traders were able to obtain any clients at all. However, private traders competed on the basis of other advantages: they offered better services - weighing, screening and rebagging; transportation from the village to the weighing station, gifts or tips to good customers after the groundnuts are sold, and interest free loans during the growing season. For those farmers who did not belong to coops or who wanted to avoid selling their groundnuts to the coops in order to evade loan recovery, private traders were an attractive alternative.

Thus, in reforming the groundnut marketing system, a basic objective was to put private traders on an equal footing with the cooperative system, as the private traders' marketing costs were clearly much lower than the cooperatives. This change required several steps. First, the amount of credit extended to GCU from the GCDB had to be reduced, in order to force GCU to reduce its costs. Second, the government had to overhaul the input distribution system. The liberalization of fertilizer marketing in 1986 theoretically put traders and GCU on the same footing in that regard.[5] Third, GCU's record on recovery of loans to farmers would have to be improved. GCU's unfair access to cheap loans for inputs had led to a lack of pressure on the coops to recover loans. A groundnut trader who did not recover the loans he made to farmers

during the growing season would go out of business. Consequently, the loan recovery rate of private traders was very high. Finally, the marketing and transport allowances paid to the private traders had to be equalized.

Even with these changes, the problem of setting marketing allowances remained. The higher the allowance, the greater the likelihood that some of the allowance would be paid to farmers and/or the cooperative administration in some form of premium as buying agents competed for customers. However, the higher the allowance, the lower GPMB's profits. The alternative was to move to a system which allowed marketing margins to be competitively determined by the GPMB setting depot prices instead of farmgate prices. The depot prices would be allowed to vary according to how far up river they were to take into account the cost of transporting groundnuts from the upriver depots to the point of final processing. If combined with a system that forced GCU to set the farmgate price sufficiently low to recover its costs, it would enable private traders to compete effectively. Farmers would be protected from predatory pricing on the one hand by retaining the option of selling across the border to Senegal and on the other, by having the option of selling to the coop network. Farmers could also band together and avoid the traders altogether by selling directly to the GPMB at the depots.

These changes were gradually implemented starting in 1986, when GPMB equalized the marketing margins it paid to private traders and the GCU. The amount of credit extended to GCU was reduced, and came under much closer scrutiny by the cabinet and the IMF. At the beginning of the 1989/90 crop season, the GPMB moved to the depot pricing scheme described above. This change eliminated the need for the GPMB to set the marketing and transport allowances, easing its administrative responsibilities. Moreover, private traders could compete with the GCU to buy groundnuts at the farmgate, with the trader with the lowest costs could pay the farmer the highest price. Since that time, private traders have taken a much more active role in groundnut trading.

5. Groundnut Processing

The third set of reforms affecting the groundnut sector focused on the GPMB's monopoly on processing and exports. The GPMB's facilities were designed to process a much larger volume of groundnuts than it was purchasing in the mid-1980s. As a result, its processing costs were high. The GPMB had the option of exporting either decorticated groundnuts, or processed oil and meal. The GPMB management continued to choose to process oil, although it was losing money in the process.[6]

In 1987, USAID began to push for a complete liberalization of processing activities, arguing that private agents would have lower

processing costs, and would chose a more profitable mix of export products than the GPMB had in the past. USAID suggested that private entrepreneurs be allowed to:

- decorticate nuts;
- process nuts into oil and meal; and
- export groundnuts and the derivative products.

USAID attached conditions to the receipt of funds from one of its grant programs to move the government in this direction.

In February, 1990, the government removed the GPMB's monopoly on exports of groundnut products. With this step, private agencies could participate in the whole chain of groundnuts activities: they could purchase from the farmers, decorticate the nuts, and sell them overseas. Moreover, the government is moving to introduce a system by which private traders could have access (for a fee) to the GPMB's processing facilities. Traders were not going to build a second processing mill to compete against the GPMB because of the relatively small size of the Gambian crop. Thus, the government introduced a system by which private traders have access (for a fee) to the GPMB's processing facilities. The government is considering the eventual full privatization of the GPMB. This step seems likely, as the GPMB purchased on 2,000 tonnes of groundnuts in 1992.

6. Concluding Observations

The long term impact of these policy changes on the groundnut sector have yet to emerge. The changes in marketing and processing will limit, if not completely eliminate, the economic and financial losses incurred by the GPMB and the GCU. Increased competition among domestic traders, with farmers able to choose among traders selling directly to exporters, to domestic processors, or across the border in Senegal, should increase farmgate prices over time.

While substantial progress has been made in the reform of trading and processing, more actions are necessary if the groundnut sector is to regain its former dynamism. The measures taken so far have had little lasting impact at the farm level. The government has to focus greater attention on policies which will improve farm productivity. In this regard, the groundnut subsidy in 1986 provided a useful one-shot injection of capital into the rural community. However, the fact that groundnut prices subsequently fell has generated confusion and distrust in the farming community.

The principal lesson of the groundnut subsidy episode is that the government should avoid taking steps that it knows cannot be sustained. There are enough uncertainties associated with economic reform without compounding them.

A further lesson is that when the government distorts incentives in ways that public sector organizations (which are notoriously inefficient) can out compete private entrepreneurs, it should ultimately be prepared to shoulder large losses. Both the GPMB and the GCU were party to the destruction of private sector activities in the groundnut sector. The government, at high social cost, has been finding it difficult to undo the damage.

Endnotes:

1. World Bank 1985c.

2. The price was derived from the Senegalese producer price (CFAF 90,000 per tonne).

3. McPherson and Posner 1991.

4. Jones 1986.

5. GCU had the advantage of having a special line of low-interest credit from the World Bank for fertilizer purchases.

6. Biggs et al. 1985:Ch.3.

6

Capacity Improvement in the Ministry of Finance

Clive S. Gray and Deborah A. Hoover

1. Introduction

Other chapters in this volume have described the obstacles to The Gambia's economic growth posed by inappropriate macroeconomic policies, external shocks, and political factors. The present chapter examines the institutional context within which the ERP was carried out, and traces efforts that were made to revamp the bureaucracy into a more effective tool for promoting growth.

Like its counterparts in most developing countries the Gambian government has assumed a large number of tasks in the interest of economic growth. The government administration, however, has proven unable to execute most of these tasks so as to come anywhere near fulfilling stated goals. The ERP attempted to deal with this gap between intentions and performance by changes in policies and institutional procedures. In the event, it was a relatively simple matter to change the macro policies. Overcoming institutional obstacles to reform has been far more difficult.[1]

The ministry of finance (MoF) has played a central role in the process of economic reform in The Gambia. Indeed, it is doubtful that the ERP could have been formulated and implemented without improved MoF performance.

This chapter describes that performance and explores the factors that influenced it. Section 2 discusses the MoF's role and performance prior to the ERP. Section 3 reviews some of the efforts made to enhance the ministry's capacity. Section 4 reviews the difficulties encountered and considers alternative remedies. Section 5 derives lessons from the discussion.

2. Performance of the Ministry of Finance

a. Responsibilities and Structure of the Ministry of Finance[2]

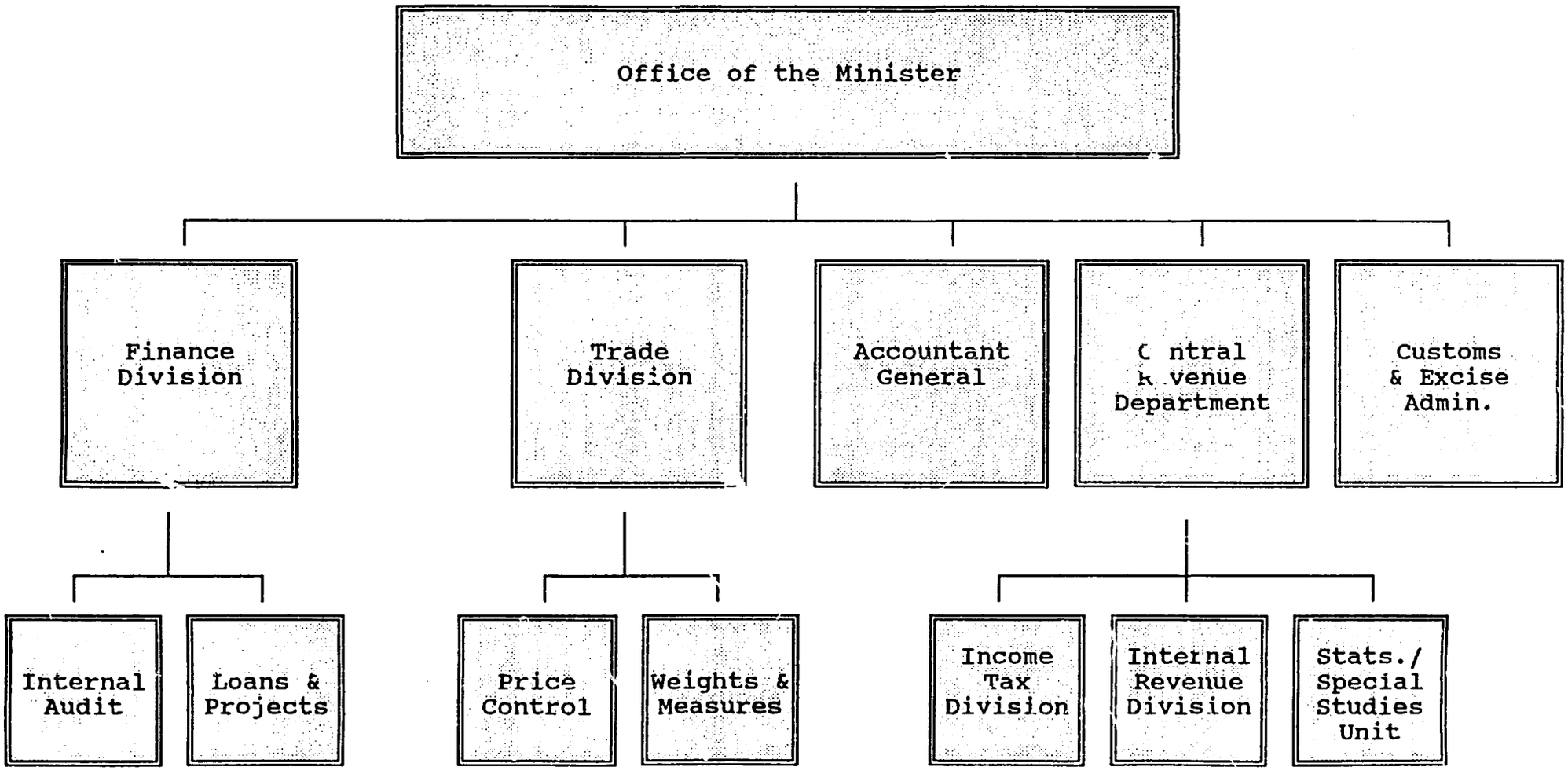
Ministry functions and responsibilities are assigned by the president and published in The Gambia Gazette. As of 1987, the minister of finance and his parliamentary secretary had responsibilities ranging from loans to civil servants to oversight of statutory corporations,[3] and ran three semi-autonomous departments in addition to the central ministry: the accountant general, central revenue, and customs and excise.

Figure 1 shows the MoF's organization chart. By 1987, it had changed little since the mid-1970s when economic planning was split off into a separate ministry.[4] The most significant change over that period was establishment of the Central Revenue Department in 1984 (see chapter 11).

The MoF's structural stability should have facilitated staff training and fostered "institutional memory". Procedures were well

Figure 1

MINISTRY OF FINANCE



established, departmental responsibilities were familiar to the staff, and much of the ministry's work had become routine. In practice, these advantages had been lost because many of the procedures had broken down and functions were being neglected. Furthermore, in the face of change in both the economic circumstances with which MoF staff had to deal and the institutional setting in which it had to operate, the ministry's unchanging structure had become a handicap.

First, the rapid expansion of the Gambian public sector starting in the mid-1970s diluted MoF control over capital spending and public debt (see chapter 14). Other ministries and the public enterprises started to contract foreign loans on the government's behalf.

Second, the expansion of government transactions, in concert with the increase in the civil service from 5500 to 10210 in the two years 1975-77 and the proliferation of public enterprises during the late 1970s, overwhelmed the MoF's accounting services and monitoring ability. Delays in computerizing several departments compounded the problem.

Third, by the mid-1980s there were virtually no MoF staff with training in the kind of policy analysis needed to respond to the economy's macroeconomic problems. Even now (mid-1992), no member of the ministry holds a Ph.D. in economics, and fewer than 30 (out of a staff of 640) have had graduate training in economics.

Fourth, during the 1970s successive ministers used the MoF for purposes other than pursuit of the public interest. In the process, the ministry acquired a reputation for corruption and inefficiency.

b. The Situation in 1982

Returning to the MoF in 1982 after a 14-year absence, Minister Sisay found the agency close to paralysis. The staff was inadequately trained, lacking motivation, subject to no effective oversight, and rarely disciplined. Even staff members with some postgraduate training performed at well below reasonable standards.

For instance, the ministry staff conducted no substantive work on economic policy. Supervision of public enterprises was purely pro forma (see chapter 7). The accountant general's department could not provide timely or accurate data on government revenue and expenditure. The loans division's external debt records were incomplete and out-of-date (see chapter 14). With the complicity of the customs administration, many importers were paying a fraction of the import duties they owed (see chapter 12). The income tax department was powerless to deal with large-scale evasion of personal and company taxes (see chapter 11). In effect, by the time Sisay returned to the ministry, its sub-standard performance was contributing to The Gambia's economic decline.

The MoF's weakness and the resulting impediment to sound economic management did not give much pause to the national political leadership.[6] Indeed, having a compliant finance ministry served the key political objective of allowing the government to continue deficit financing instead of having to adjust through expenditure control or increased tax collection.

With reorganization and a change of leadership, the problems of indiscipline and corruption could be addressed rapidly. How to restore sense of commitment and improve the skills of the staff were more complicated.

In the event, some improvements occurred during the period of formulation and implementation of the ERP. How did this come about? One factor was the leadership provided by the minister (see chapter 18). Other factors, which comprise the focus of this chapter, were technical assistance and training.

After only a few months on the job Sisay asked the British Ministry of Overseas Development for help in revitalizing the accountant general's department. He likewise approached the U.S. Agency for International Development (USAID) for technical assistance in policy analysis.

The British responded by providing an expatriate accountant general, who arrived in February 1984. He was later joined by a data specialist who computerized the department's operations. USAID responded by requesting one of the authors (Gray) to help the minister identify priorities for technical assistance.[7] The initial consultancy in March 1983 encompassed a review of the MoF staff's skills and training needs, guidelines on income tax reform (see chapter 11), and the initial design of a program of technical assistance and training which ultimately led to the EFPA project.

c. The Government's Administrative Reform Program

Recognizing that the MoF's institutional weaknesses were common to the Gambian public sector as a whole, those who designed the ERP included civil service and parastatal reform as major themes of the program. In its initial stages civil service reform addressed the question of redundant staff. By 1987, over 3,000 positions, or roughly 25% of the pre-ERP civil service establishment, had been eliminated. This retrenchment was part of a broader Administrative Reform Program (ARP).

That component of the ERP called for overhauling civil service operating procedures, the salary structure, and hiring and firing practices. A Personnel Management Office was set up in the Office of the President, and a program was drawn up for review and reorganization of key ministries other than the MoF. The MoF itself was reorganized only in 1990.

During the ERP's initial stages, the lack of attention to the organization of the MoF reflected the general disarray and inefficiency in the operations of other ministries. The minister was also concerned that reorganization would divert the attention of MoF's staff from the urgent task of implementing the ERP. Moreover, because the minister was aware that powerful public sector interests were opposed to his economic reforms,[8] he did not trust senior civil servants to do the job apolitically.[9]

3. Capacity Improvement

Efforts to improve MoF staff capacity faced several constraints.

First, everyone in the ministry, from the minister on down, needed additional training to carry out his or her assigned tasks.[10] A large-scale training program of the type needed would disrupt the ministry's work. Other options had to be found.

Second, The Gambia's economic problems required immediate attention, and the existing staff were not competent to tackle many of them. While the rest were subject to diagnosis by consultants hired through technical assistance, this posed the risk of compounding The Gambia's dependence on foreign aid. The minister, however, saw no alternative.

Third, in some units the skill level was so low that staff needed basic training simply to meet admission requirements for overseas training.[11]

Fourth, given the limited number of skilled Gambians in all fields, any training effort risked a high rate of attrition as trained personnel shifted to more lucrative positions in public enterprises, the National Investment Board, the central bank, donor agencies, and the private sector.

a. Elements of Capacity Improvement

For structural adjustment and economic reform to succeed both policies and institutions have to change. Implementing the changes on a sustained basis requires improved capacity. A large literature considers how to achieve this, and efforts are regularly made to formalize the idea. One example is the program currently led by the World Bank known as the Africa Capacity Building Initiative.

Less was known about this field when technical assistance got underway in The Gambia's finance ministry. The point of departure for the initiators of this program was the definition of capacity in Webster's Collegiate Dictionary, "the power to grasp and analyze ideas and cope with problems". This definition has several implications.

First, it highlights two aspects of capacity, namely, the ability to recognize key features of a situation, and the competence to deal with them in a relevant way. For instance, many non-economists believe that overvalued exchange rates can be dealt with through controls. An economist, however, understands that controls do not eliminate the source of the excess demand for foreign exchange which creates the overvaluation. Controls simply suppress or divert that excess demand; they do not eliminate it.

Second, since the power to "analyze and cope with problems" has numerous dimensions, capacity can be improved in a variety of ways. Obvious examples are on-the-job training, short lecture courses, seminar series, formal degree training, and internships.

A third implication is that specific capacities can become irrelevant as problems change. For instance, at the time the dalasi was floated in 1986, price control was abolished. The result was that the skills and procedures needed in price regulation became irrelevant.

Fourth, capacity improvement has to be seen as a matter of degree rather than kind. The "power to grasp and analyze ideas" is relevant within a specific context. To illustrate, a well-trained macro economist has the ability to review the key economic aggregates and assess the proximate causes of a country's economic problems. But he/she generally lacks the skills to determine how and whether reform of the tax reform or the public enterprises, for example, will help overcome the macro problems. Although, he/she could ultimately acquire those skills (through capacity deepening), the usual solution is to turn the task over to the specialist in taxes and public enterprise reform.

Four distinct skills are associated with these various abilities. We have found it useful to call them - strategic, administrative, technical, and communication.[12]

- Strategic capacity enables an individual to recognize economic problems and place them in their appropriate context;
- Administrative (or managerial) capacity is the ability to organize the activities of diverse groups of individuals and institutions to deal with particular economic problems;
- Technical (or analytical) capacity is the ability to conduct detailed analyses of these problems;
- The capacity to communicate provides an individual with the skill to reach and respond to individuals and groups relevant to specific economic problems.

No individual develops all of these skills to an equal degree. Therefore, to resolve policy issues typically requires the cooperation of individuals with different skills. Some people will be more adept at conceptualizing the issues; others at assembling the people needed to have them analyzed; others will have the

skills to analyze the problems and determine their implications; and others will be able to communicate (or foster the necessary communication) among the relevant individuals who have been cooperating to resolve the problem.

b. Capacity Within the Ministry of Finance

Only a few people in the MoF had developed the above skills to any significant degree. It was unusual for any one to think of economic issues in strategic terms. No models of the economy had been developed; monetary programming was used only by the staff of the International Monetary Fund (IMF); the government did not develop a rolling plan; and the annual budgeting exercise passed by with minimal discussion of government priorities (see chapter 10). Indeed, until minister Sisay appointed the ERP task force, no group of officials had ever been assembled The Gambia's economic problems in such a comprehensive way.[13]

Several studies of the ministry revealed that its administration and management were a shambles.[14] A highly personalized system of administration revolving around the permanent secretary had evolved. Moreover, despite a commitment to training and much effort in this area, the average skills of the ministry staff were not increasing. Many of those who had been trained became discouraged and left.

Finally, communication among ministry officials continued to be difficult. A problem has been the heavy reliance on ex-patriates to formulate and write basic documents (the budget speech, cabinet memos, and analytical reports). A more fundamental problem, however, has been an erosion of trust. Many senior ministry officials have found that their attempts to communicate with the public about the economy were greeted with skepticism. Indeed, one reason that the measures introduced in the ERP met little resistance, was that few Gambians believed that the government was serious about reform (see chapter 2).

Most of the above deficiencies can be attributed to the lack of skills, but political considerations and opportunism also had a role. The agenda pursued by some senior officials of the ministry was, frequently, unrelated to national development. One obvious example, is the repeated failure of the ministry and government to deal decisively with customs fraud (see chapter 12). That failure was not due to technical or administrative considerations since the problem was understood and had been well documented; its consequences had been thoroughly analyzed, those responsible had been identified, and the evidence to deal with past transgressions was readily available both locally and abroad.

4. Training Within the Ministry of Finance

Training offered the potential for achieving marked and sustained improvements in the productivity of the ministry's staff. Training raises productivity by improving an individual's facility with his/her existing tasks (skill-deepening) and by increasing the range of tasks in which each employee can excel (skill-broadening).

Both types of training occurred in the ministry. Training of a skill-deepening nature was undertaken within the ministry through the introduction of computers. Prior to September 1985, there were no computers in the ministry besides the mini-computer used by the accountant general for payroll processing. The computers (PCs) introduced to the ministry in 1985 were the first to be integrated into the ministry's operations.

Computerization affected every aspect of the ministry's operations - the budget, monitoring of the World Bank/IMF programs, balance of payments and national accounts, debt reporting, income tax, and the analysis of trade and customs data. Many other items such as the budget speech, cabinet memos, and routine items of correspondence were put handled through the word processor. All computer operators were trained locally.

On-the-job training both at the ministry and at the Management Development Institute (MDI) offered numerous opportunities for ministry staff to improve their skills in various analytical techniques. Instruction was provided in budgeting, fiscal policy, micro and macro economic analysis, regression analysis, and accounting procedures (among others).

The local training effort was important primarily because it could be directed to the immediate needs of each employee. It was supplemented by training abroad. This took the form of conferences, summer workshops, summer schools, remedial and refresher courses, short-term professional training, conventional undergraduate training, and specialized masters level training. Trainees took courses in a wide range of economic, financial, management, and administrative topics.

a. Approach Adopted

The EFPA Project involved a great deal of training. It is instructive to look at this experience in order to understand the preconditions for, and the constraints on, building the kinds of capacities that are described above.

The decision was taken at the beginning of the project by the permanent secretary and the EFPA project director that it would not be appropriate for the ministry to attempt to build up the SSSU (now the MFAU) by attracting staff from other parts of the government. That would only weaken the units from which the staff

were drawn. Therefore, it was agreed that the staff of the SSSU would be promoted from within the ministry, and that their skills would be enhanced through appropriate training on-the-job, in local courses, and abroad.

That approach has draw-backs. First, it takes many years (perhaps as much as two decades) for the creation of a coherent, well-functioning, and self-sustaining policy unit. For most of the staff, a special effort was needed initially to bring them up to standards which provided access to tertiary education in the United States. Fortunately, there are many non-degree programs which have low entry standards.

Second, the on-the-job training is a time consuming activity for foreign advisors. The HIID team devoted a great deal of its time to conduct what in effect, was a continuous tutorial with selected members of the ministry. In this way the technical analysis done by the advisor could be directly linked to training.

Third, key staff can readily be lost to other agencies. This has occurred in several ways. Staff who were specifically trained for particular positions may not be assigned to them. Staff who have been trained may leave. And, staff who wish voluntarily to join the unit from other parts of the government may not be permitted to. There were examples of all cases. We cite one such case to illustrate the point. In 1986, a former member of the weights and measures unit was assigned by the permanent secretary to work in the SSSU as a trainee statistician/economist. At the time, she knew practically no economics, had no familiarity with computers, and had only the rudiments of typing. She had graduated from high school with "O" levels. With time, a program of on-the-job training, individual coaching in basic economics, and selected short courses - a project appraisal course, the HIID budget workshop, and special courses at Boulder - she became one of the most productive members of the ministry. She now works for an aid agency.

Finally, it takes time before there are enough staff within the ministry who have the requisite redundancy of skills to "cover" for those who from time to time are absent. Vacations, special assignments, travel, maternity leave, personal days, and training courses all take staff away. Without adequate staff, the task of maintaining the "institutional memory" and effectively covering the gaps falls on the technical advisors.

b. Political Aspects of Training

Training confers unique advantages for those selected. It enhances their personal skills and raises their expected future earnings. Training provides an opportunity for travel and cultural interchange. Many trainees experience significant improvements in their standards of living while they are abroad Graduate level

training, especially in business or financial management, raises the opportunity for individuals to enter the international job market.

In a word, training generates economic rents. Control of access to training is therefore an important part of the "spoils" system in a poor country. Such was the case in The Gambia. This was evident in the frequency with which heads of departments nominated themselves for training.[15] It also accounted for the pressure which is routinely applied to project staff to send particular individuals for training. That pressure was easy to deflect.[16]

The HIID summer workshops proved to be ideal for providing heads of departments with some training. They were short enough not to tie up senior officials for too long. They occurred at a generally slack time in The Gambia (July/August). And, they contained enough material that the trainee was challenged without being overwhelmed.

Sending the heads of departments out for training served the useful purpose of allowing the training efforts to focus on staff lower down the hierarchy. Most of the project's training resources were devoted to them.

While control of access to training served specific purposes, the motives of Gambians for training was also important. They varied widely. For some it was a way to "get out of The Gambia"; for others it was to broaden their life experience; while for others it is an opportunity to enhance their skills and further their careers. It was possible to screen out the many of most students" and those who wanted a shopping trip to the US, but some got through.[17] Numerous trainees used their attendance at short courses as scouting opportunities for long-term training activities.

c. Reintegration of Trained Staff

Under a grant agreement with USAID, the government would make every effort to promote the trainees and to use them effectively when they returned. Some trainees were promoted and, because the work load on the ministry was so pressing, many of them were expected to assume additional responsibilities. A drawback, however, has been that because the administration of the ministry had not improved substantively, the trainees were still subject to the disarray and disincentives which reduced their productivity before they had been sent out.[18]

By failing to reorganize, the ministry lost important opportunities to reduce the duplication of effort, better relate employees' skills to the tasks they were expected to perform, and improve staff supervision. Staff evaluation suffered as well because it was difficult to discern whether an individual's poor performance was due to his/her lack of effort or the disorganization with which

he/she had to cope. Much of the benefit of the training was lost.

An additional problem was that some of the more highly motivated trainees encountered real difficulties when they resumed work in the ministry. They often became impatient with the lack of motivation and inefficiency of their colleagues. Some found their opportunities for promotion blocked on criteria besides merit. Others found that they had no desire to accommodate to the "spoils system".

For those who were impatient for promotion, who were not prepared to bend their principles, and those who would not accommodate to the ministry's standard of performance, the only option was to leave. That occurred frequently, especially among the trainees whose performance was above average.

5. Concluding Observations and Lessons

Structural adjustment depends on institutional changes as well as policy changes. Institutional weaknesses can be offset in the initial stages by technical assistance. Ultimately a cadre of staff who are motivated, skilled, competent and honest have to be developed. Doing this in a ministry which is in the midst of implementing a structural adjustment program for a government that is itself in the process of undergoing reform is demanding.

Sustaining the effort after the most urgent need for adjustment has passed is even more demanding. One of the unfortunate costs of the type of disruption which occurred in The Gambia is that the organizational disarray has ruined the work habits and morale of many officials. Under these circumstances, training is only part of the process of improving productivity and reviving a sense of responsibility.

One lesson which emerges from The Gambia's experience is that training and institutional reform have to occur simultaneously. Despite the potential political consequences and the internal resistance, it was a mistake to assume that the institutional reform of the ministry could be delayed. In retrospect, the MoF should have been one of the first ministries reorganized under the ARP. The delay compromised much of the benefit of the training which was subsequently provided.

A second lesson is that, paradoxically, the availability of technical assistance has been an obstacle to institutional reform. While the donors continued to fund technical advisors and consultants who could and would do most of the critical analyses and monitoring within the ministry, there was no need for the local staff to be better motivated and more productive.

Notwithstanding these drawbacks, the training opportunities provided to the ministry staff had several positive effects. This was evident in a variety of ways. The standard of economic discourse within the ministry improved; arguments made for and against particular positions were more cogent; criticisms of long-established ideas became more insightful; the willingness of individual staff members to take positions on economic issues and defend them increased; and many of the lower level staff came to understand better the reasons for the economy's difficulties, the types of changes that would have to be made, and why. Perhaps the most encouraging factor was that the type of work that the technical assistance staff had to undertake on a regular basis has changed substantially over time. Initially, all data collection and collation had to be done by the technical advisors; over time that function was shifted. Similarly, the drafting of key memoranda and analysis of policy issues was a basic function left to the advisors. With the general improvement in staff capacity, much of that work was moved as well.

The economic advisors have not worked themselves out of a job, which is the standard criterion by which such efforts are judged. However, they have worked themselves out of many jobs. That the advisors are still productively employed in the ministry reflects the fact that the initial level of skills was so low and that the nature of the policy analysis required has changed over time. Continued training will address the first issue; continued enhancement of strategic and technical capacities of Gambian staff will help address the second. Ultimately, the combination of reorganization, better management, and training will leave the ministry's work entirely in Gambian hands.

Endnotes:

1. GOTG 1987.

2. In September 1990, the finance and economic planning were combined in a single ministry. The trade division was transferred to the newly formed ministry for industry, trade and employment. For the sake of simplicity, we refer to the ministry of finance or MoF.

3. The full list was:

> Advances to public officers, Auctioneers, Audit Reports, action on Balance of Payments, Banks and Banking, Bills of Sale, Board of Survey, Currency and monetary policy, Trade and commercial policy, Customs and Excise, Exchange Control Policy, Export licensing, Financial control, Hire purchase - credit sales policy, Import licensing, Income Tax, Insurance, International and other overseas financial and trade organizations - financial, technical and professional relations with
> Loans, international and external - public debt
> Losses of funds and stores
> Money lenders and pawnbrokers
> Pensions and superannuation schemes - policy
> Pools betting, price control, Public Accounts Committee Reports - action
> Recurrent Budget, Revenue collection, Revolving Loan Fund, Stamp Duties, Statutory Corporations:-G.P.M.B., N.T.C.G., G.N.I.C.

Source: The Gambia Gazette no.1, vol.104, Banjul, 1st October 1987

4. To form the ministry of economic planning and industrial development (MEPID).

5. The skills shortage was documented in 1983 the consultant's report cited below. Key gaps identified in the survey included knowledge of:

- macroeconomic theory and analytical tools for short-run policy formulation;
- techniques for allocating government expenditure, including project appraisal;
- tax incidence and tax administration.

The findings were incorporated in USAID's justification for technical assistance to the MoF (USAID 1984).

6. Obviously, the president had come to see the ministry's performance as a problem. By recalling Sisay to the ministry, the president explicitly recognized that he had run out of options.

Although both Sisay and Jawara had helped establish the PPP (People's Progressive Party) and both were members of the pre-independence government, their rivalry had intensified as the 1960s progressed leading to a widely publicized falling out.

7. Although the donor agencies were responsive, segments of the Gambian administration resisted Sisay's use of foreign advisors. For instance, Cabinet opposed the appointment of the Accountant General, only to be overruled by the president. Some senior civil servants strongly objected to the use of HIID advisors in the MoF.

8. The appointment of a new permanent secretary dragged out over thirteen months due to resistance within the civil service. The process normally takes a little over 3 months.

9. Just before going on medical leave in 1987, Sisay instructed the permanent secretary to have an HIID consultant prepare a reorganization plan for the ministry. That directive was never followed through. Two years later, when fundamental reform was long overdue, the permanent secretary requested the EFPA project to pay for a study of MoF operations and management by the Management Development Institute (MDI 1989).

10. Minister Sisay took advantage of his annual leave in 1984 to be a Visiting Scholar at Harvard University during which time he attended lectures and seminars and worked on a paper later delivered at Vanderbilt University.

11. Most MoF technical staff had only high school diplomas - "O-levels" (the majority) and "A" levels - supplemented by on-the-job experience. None of the staff could qualify for overseas training without remedial courses in economics or accounting.

12. Mann and McPherson 1981.

13. Notwithstanding the teams of economists and planners which assembled to formulate the first and second five year plans and the mid-term review of the second plan. Their task had been to derive a plan through the aggregation of sectoral activities. No one group had been responsible for determining whether the individual sectoral initiatives were consistent.

14. MDI 1989.

15. A decision had been taken that the EFPA project should train heads of departments, so the obvious conflict of interest was ignored.

16. The U.S. Ambassador had instructed all members of US assistance to report such influence-peddling.

17. Since the project was only one of several sources of training funds, those who were determined to travel abroad could usually find some organization to support them.

18. The reorganization of ministry in September 1990 did not address that issue either. With the recent appointment of a new minister (May 1992), the prospects for such a reorganization have improved.

7

Parastatal Reform, Performance Contracts and Privatization

Richard M. Hook, Richard D. Mallon and Malcolm F. McPherson

1. Introduction

Like most countries in Sub-Saharan Africa, The Gambia created public enterprises (PEs) to serve a number of economic and social purposes. At independence, there were four such enterprises;[1] by 1985, there were 20.

PEs (or parastatals as they are also known) were easy to create - operational departments of existing ministries were incorporated; joint public-private ventures were formed; existing firms were taken over; and new enterprises were established. PEs were required to engage in commercial activities and provide public services, such as retail trade and drought relief. They were frequently subject to restrictions related to the prices they could charge, the wages they could pay, and their hiring practices. Creating PEs and directing them to perform specific functions, however, were trivial relative to the tasks of effectively managing the enterprises in the public interest, ensuring that standards of accountability were met, and that operating efficiency and cost recovery were given adequate attention.

The number of PEs began to increase from the early 1970s and the activities of existing PEs expanded. Initially, PEs made a positive net contribution to national income and domestic savings. That situation changed toward the end of the 1970s when they became a net financial drain on the economy.

Nonetheless, there were strong pressures within the government to create additional PEs.[2] Members of the donor community were less sanguine. They saw a direct connection between the poor performance of the PEs and the economy's difficulties.

This chapter examines parastatal reform in The Gambia. Section 2 briefly reviews the role of PEs in the economy. Section 3 discusses the main elements of the parastatal reform program, namely the performance contract system and divestiture. Section 4 highlights some of the problems encountered during its implementation. Section 5 considers issues related to monitoring of the performance of the PEs. Section 6 concludes with lessons from the Gambian experience.

2. The Role of Public Enterprises

Public enterprises have a long history in The Gambia. The first, the Gambia Savings Bank - better known as the Post Office Savings Bank - was established in 1922. The Gambia Oil Seeds Marketing Board, which later became the Gambia Produce Marketing Board (GPMB), was formed in 1948 and the Gambia Central Cooperative Banking and Marketing Union Ltd. (the forerunner to the Gambia Cooperatives Union) was created in 1955.[3] Some organizations such as the Gambia Ports Authority (GPA) and the Gambia Utilities

Corporation (GUC) used to be operating departments of the ministry of works and services (later the ministry of works and communications). Some PEs were created when the government took over the assets of foreign-owned organizations. The National Trading Corporation, for example, emerged when the government bought the assets of the United Africa Corporation. Finally, other PEs were simply created. The Gambia Commercial and Development Bank (GCDB) was formed in 1972 by an Act of Parliament.

PEs have been important in the performance of the Gambian economy. Until the mid-1970s, the operations of the GPMB were larger in absolute terms than those of the government itself. PEs became especially significant following the introduction of the first plan in 1975 as they were seen as an integral part of the government's attempt to accelerate economic growth and promote development.[4]

During the decade 1971 to 1981, 20 PEs were created (Annex A). Their activities related to all major aspects of the economy - from fishing and tourism, to retail trade and insurance. Due to the general expansion in the economy, the buoyancy of world markets, and the sharp rise in foreign aid, the PEs made positive net contributions to formal sector employment, domestic value added, domestic savings, and net foreign exchange earnings. That contribution diminished as the limits of the domestic market were reached, and the profitability of the GPMB was undermined by an increasingly overvalued exchange rate, low output due to drought, and declining foreign prices for groundnuts. During the period 1979 to 1982 the PEs experienced net losses of D112 million.[5] The GPMB was particularly hard hit. By 1978, it had accumulated reserves of D106.5 million, equivalent to $54.6 million or 26% of GDP. Its reserves were exhausted by 1982. By June 1983, the GPMB was in debt by more than D100 million - approximately $37 million - to the central bank.

Reasons for the reversal in GPMB's fortunes were the transfers to government budget, large losses in groundnut trading, an inability to control costs, and the diversion of resources to peripheral activities.[6] The GPMBs losses and those of other parastatals were financed by bank credit which added pressure to the already over-extended financial system (see chapter 8).

By the time the ERP was formulated, the PEs were a major financial drain on the whole economy. Fundamental reform in their operations was overdue.

3. Parastatal Reform

Even without the ERP, the World Bank and USAID had begun to press for the reform of key PEs. Studies of the financial system and the groundnut sector highlighted the precarious financial state of both the GCDB and the GPMB.[7] The studies showed that government

interference in the operations of both organizations had adversely affected their economic performance. A key conclusion was that the relationship between the government and the PEs had to change. Privatization (divestiture) and performance contracts were seen as being the most effective means of achieving that objective.

Privatization would allow the government to disengage from activities that it could not properly manage and for which there was no compelling public reason to be involved. Performance contracts provided a means of improving the management of enterprises which the government would not or could not divest. The World Bank pushed hard for both initiatives; they were subsequently included in the ERP.

Some MoF officials recognized that parastatal reform had to be part of any effort to revive the economy, but within the government itself there was no enthusiasm for privatization. There were several reasons. First, some PEs such as GPA and GUC were monopolies. The creation and subsequent regulation of private monopolies to provide port services and basic utilities (electricity and water) were not viewed as positive steps. Second, many government officials viewed PEs such as GPMB and NTC as being "strategic" to the country's development. They believed that the government had a public duty to maintain control of the key export enterprise and the only nation-wide wholesale/retail firm. Third, the PE managers formed an influential lobby. Both reforms threatened their positions. Fourth, some PEs served political purposes. They operated in controlled markets, generating rents that were used to obtain or retain political support. The government was particularly sensitive to suggestions that the PEs which operated in agriculture be reformed. Finally, the PEs provided a convenient means of transferring public resources to the private sector. The transfers occurred in several ways - inflated salaries and perquisites, opportunities for foreign travel, cheap loans that were rarely required to be repaid, overstaffing, nepotism, and outright corruption.

Resistance to parastatal reform was potent and generally delayed the whole reform effort.[8] It has only been overcome through donor pressure. In the case of GCDB, the process dragged out from 1986 to 1992; for the GPMB, it continues.

Yet, some delay was inevitable. The original schedule for implementing the performance contracts included in the ERP, namely to have four PEs (GPMB, GUC, GPTC, and GAMTEL) under contract in the first year, was too ambitious.[9]

a. Performance Contracts

The basic approach to the introduction of performance contracts was outlined, after several delays, by the National Investment Board (NIB) in October 1986 in a document entitled the "Divestiture

Strategy Action Plan". Six PEs - CPMB, GPA, GUC, LMB, GAMTEL, and SSHFC - were classified as being "strategic". Although some of their peripheral activities would be sold, the core of their operations would be retained by government and reorganized under performance contracts.

The purpose of performance contracts was to allow the PEs greater autonomy while holding their managers accountable for results. Greater autonomy from bureaucratic regulations was justified on the grounds that parastatals are expected to behave like businesses with primarily commercial objectives. Their managers should therefore be treated as businessmen or businesswomen and be held accountable for the results they achieve, not for how well they comply with procedural regulations. This "arm's length" relationship between government and the PEs is spelled out in contractual obligations that include enterprise performance targets, government financial and regulatory commitments, and specific rewards and penalties linked to contract compliance. To facilitate the monitoring of performance, all transactions between the parties are supposed to be transparent. For example, government transfers or subsidies to parastatals were to be based on the cost of performing non-commercial services and included as explicit line items in the government budget.

Three such contracts were initiated in 1987 when the GPMB, the GUC, and the GPA entered formal agreements with the government.[10] The NIB was given responsibility for monitoring PE performance under the contracts.

b. Privatization

The action plan referred to above did not discuss the criteria used to distinguish between strategic and non-strategic PEs. However, the non-strategic enterprises were potential candidates for privatization.

The objectives of privatization were to improve overall economic efficiency, reduce fiscal losses, broaden the ownership of economic enterprises, and gain access to additional sources of private savings.

Economic efficiency was expected to improve when the private entrepreneurs who acquired the PEs cut costs and/or raised revenues. For most PEs in The Gambia, costs could be readily cut by better work practices, better inventory control, and the retrenchment of labor. Revenues could be increased by improved cash management, the collection of overdue bills, and appropriate pricing decisions. Crucial elements were reorganization and improved management. These were expected of private entrepreneurs whose direct stake in ownership provided them with the incentives to focus more intently on net returns. Public sector managers, many of whom were political appointees, often treated profitability

as a constraint rather than an objective.

Privatization would reduce fiscal losses in four ways. First, the privatized enterprise would be liable to income tax.[11] Typically, all PEs in The Gambia have been exempt from income tax. Second, the operating losses of the PEs would no longer be a contingent liability on the government. A major drain was on government resources created by the need to meet many of the debts incurred by the PEs (see chapter 14). Third, to the extent that the sale of PEs reflects improved private sector confidence, government revenue would benefit as income increased. Finally, the sale of PEs would add (albeit marginally) to government revenue.[12]

Broadening the ownership base was an explicit government objective. The action plan mentioned earlier, sought to create the conditions which would encourage a broad-based Gambian entrepreneurial class while avoiding major concentrations of ownership. Employee participation in ownership was stressed.

The action plan proposed an ambitious timetable for the sale of government shares. For instance, it was hoped that the shares of Banjul Breweries would be sold by October 1986, and Africa Hotels (Sunwing) by March 1987. Neither of these targets was met.[13]

4. Parastatal Reform: Issues, Concerns, and Problems

Numerous issues have arisen during the implementation of the parastatal reform program. These relate to the regulation of PEs, the imposition of "hard" budget constraints on both the government and the PEs, the time needed to prepare PEs for performance contracts, the complexity of those contracts, and the supply of domestic savings to support the privatization effort. A further issue has been the institutional capacity to monitor the reform process.

Rationalizing the ownership and control of PEs automatically raises the issue of regulation. A strong case exists for deregulation before sale, although in the case of enterprises which face limited competition the regulations are less likely to be removed. In The Gambia, complications arose because it was unclear where the responsibility for regulating the PE lay, with the line ministry or the NIB.[14] In the case of the GUC and the GCDB, that confusion provided their respective managements with numerous opportunities to obstruct the reform process.[15]

The government adopted an ad hoc approach to deregulation. For example, the GPMB was excluded from importing rice but GCU was not. This subverted the general intention of liberalizing the rice market, namely to get the government out of the commercial importation of rice. The situation remains unresolved although GCU has had trouble competing with the private sector traders in this

line of business. The Nyambai sawmill which was sold in 1988 faces virtually no domestic competition and has access to a public resource (the Nyambai forest). If the government wants the forest replanted, as agreed at the time of the sale, marked improvements in public oversight will be needed.

The performance contracts were part of the process of imposing "hard" budget constraints on both the government and the PEs. They were designed to establish explicit objectives for the PEs and determine the activities which the government could reasonably expect the PEs to undertake. In doing so, they clarified the responsibilities (and duties) of the government officials who were monitoring the performance of particular PEs and the managers of the PEs themselves. Such a statement of responsibilities and obligations provided little room for the all-too-common practice of shifting blame for sub-standard performance or financial difficulties.

It was recognized at the outset that some detailed preliminary work would be needed to prepare PEs for divestiture and/or performance contracts. The three enterprises chosen initially, the GPMB, GPA, and GUC, represented a mix of PEs that were in deep trouble (GUC), too large to ignore (GPMB), and relatively easy to deal with (GPA). It was expected that once the reform program was underway, time and effort would be saved due to the existence of monitoring procedures, the supply of trained staff, and the general build-up of experience. In practice, the process has been more complex and time-consuming than either the government or the donors imagined.

The cost-savings have proven to be illusory. The preparation and implementation of the second round of performance contracts - for SSHFC, GAMTEL, and GPTC - was so delayed that much of the initial learning experience was lost. Staff were reassigned, new consultants adopted different approaches, and the economic circumstances changed. Moreover, so much time had been absorbed in dealing with the problems of the GPMB and the GUC that the follow-on contracts received less attention than was anticipated, or they deserved.

A further problem was that the performance contracts were overambitious in scope and timing. The proposal in the ERP to implement performance contracts for four major PEs, including the giant GPMB, in the first year of the program, was a triumph of optimism over capability. The scope of the program was simply too large for the implementing capacity.

Similarly, the attempted timing of the reforms was too ambitious. In October 1986, the NIB reminded the first group of targeted PEs that the trial run for performance contracts would begin in December. The PEs were instructed that preconditions to operating the contracts included clear ministerial statements of policies and objectives for each PE; settlement of liabilities with other PEs;

government agreement to provided financial support for non-commercial PE activities; and agreements on the reorganization of boards of directors, and on capital restructuring.

For privatization to succeed, there have to be individuals or firms with access to resources to effect the transfer of ownership. Initially, there was some concern that the savings needed to allow individuals and firms to purchase the PEs were not available. The largest portfolio of liquid assets in The Gambia was held by the SSHFC. But, it was 100% government-owned. The issue was not as clear cut as it first appeared. There were many people willing to buy shares in profitable, well-managed enterprises, such as Standard Bank.[16] Indeed, judging from overseas deposits held by Gambian residents of $80 million in 1985 (37% of GDP), resources were not a problem. Lack of confidence in the economy and specifically lack of confidence in the willingness of government to stay out of areas it had decided to privatize were far more important.[17]

One issue that has not been addressed in the privatization program has been the quality of the investor. Clearly, in cases where there is competition for the PEs assets, some vetting of the applications occurs. There is obviously not enough, however. A large PE was recently sold to an entrepreneur who in several separate investigations was revealed to have been one of the worst perpetrators of tax fraud in The Gambia.[18] The public property has been paid for by funds which were obtained from the government by fraud in the first place.

Several other technical issues arose with regard to privatization. How would the assets be valued given that their book value was entirely unrealistic and no effective market existed?[19] What would be done with the accumulated debts and arrears on that debt. Would potential purchasers be provided with credit to purchase the shares? On what terms? Would changes be made in the system of taxation of income and capital gains? Some analysts saw the rate of company tax (50%) as a deterrent to investment. What supporting measures would be needed to enhance the liquidity and transferability of the shares?[20] Would the newly-privatized entities be given preferential treatment under the Development Act?

The initiation of the performance contract system, on its own, boosted the performance of several PEs. There was a demonstration effect associated with the threat of divestiture and the managerial scrutiny involved in negotiating a performance contract. These were strong signals to the managements of PEs in general that the government (supported by the donors) would be less indulgent of inefficiency than they had previously been.

A further issue is the system of rewards and sanctions needed to make the performance contracts effective. The rewards and sanctions must be clear, reasonably simple, and enforced. Even

after the first round of performance contracts had been signed, attempts were being made to develop an acceptable approach to calculating performance. The proposal put forward in 1988, for example, included 16 separate indicators, some quantitatively measurable, and others a matter of judgement. Complex scoring schemes with many criteria make pinpointing responsibility difficult, and can lead to manipulation by management. Under the system of scoring suggested in 1989, it would have been possible for the GPMB management to sustain a massive net loss, fail to service its debt, allow its evacuation rate to worsen, and fail to maintain its fixed assets, while still collecting a bonus of one year's salary. That complex, unwieldy system did not focus on the basic criterion of operating results. Moreover, there were no punishments specified for egregious failure to meet targets, other than an "investigation" if results were scored 45% of total possible marks or lower.

The main sanctions used so far have been the replacement of the PE managers. The president has fired managing directors of the GPMB on two separate occasions. The MDs of the GUC have been replaced twice as well. While these steps indicate that sanctions of some form do indeed exist, their usefulness as a signal of the government's commitment to reform is problematic. The changes occurred after the donor community made its concerns known about mismanagement and malfeasance in both organizations.

Finally, concerns have arisen over the ability of the government and its agent, the NIB, to monitor effectively the performance contracts and privatization program. We take this up in the next section.

5. Parastatal Performance and the National Investment Board[21]

The limited capacity of the existing institutions and their staff to support the divestiture program and system of performance contracts has been a major weakness confronting the government. A key organization in this regard has been the NIB. From its inception, one of the NIBs responsibilities has been to represent government's interests relative to the PEs. In this capacity, the NIB provided commentary (at times cogent) on the economic and financial affairs of the PEs. In its early years, neither the government nor the PEs took much notice of NIB's views. It was an organization without a role.

As the performance of the PEs continued to degenerate, it became increasingly evident that neither the line ministries nor the government (through the cabinet) could or would exercise the leadership needed to rectify the situation. Donors searched for alternatives. The NIB had several attractive features. First, its chief executive reported directly to the president. Therefore, the potential existed for gaining high-level support for parastatal

reform. Second, the NIB staff were young, energetic and relatively well trained. Moreover, they generally showed some appreciation of the basic problems confronting the PEs. Third, NIB had a separate budget so its salaries were attractive enough to retain its better-trained staff. Finally, the NIB already had the statutory responsibility for overseeing government interests. This avoided having to create an additional institution.

There were disadvantages as well. First, the NIB had almost no authority. The capacity to monitor performance meant little if the PEs and line ministries would not cooperate. Second, many of the problems with the PEs were political. The technical competence of NIB would be ineffective until the political climate had changed. Third, the risk existed that the NIB itself may become another interest group. By thrusting the NIB into such a prominent position, there was the possibility that it may become part of the problem rather than part of the solution.

Despite these drawbacks, the government and the donors believed that NIB should become the lead organization in the parastatal reform program. A major effort was therefore needed to strengthen NIB in ways that enabled it to fulfill its expanded role.

The introduction of performance contracts clearly required major organizational and procedural changes:

- in the supervision of parastatals;
- in government financial controls; and
- in the flow and use of information.

Responsibility for the supervision of parastatals has traditionally been entrusted to sectoral ministries, acting both directly and through boards of directors over which they exercise considerable influence. Performance contracts, which are negotiated between parastatal managers and the NIB acting on behalf of the president, constitute a parallel system of supervision since the roles of sectoral ministries and parastatal boards of directors have not yet been redefined.

Government financial controls of parastatals have traditionally been lax: expenditures have been subsidized after the fact, no penalties have been exacted for bills not paid on time or for the accumulation of arrears, and bank credit has been regularly used to finance parastatal deficits.[22]

The flow of information within parastatals and between them and government has traditionally been input-output oriented. Information on cash flow, profit margins, sales to inventory ratios, and other financial variables regularly monitored in business firms is largely ignored if gathered at all; and annual financial statements are frequently submitted a year or more late. Indeed, parastatal managers themselves seldom have any precise idea

of how the performance of their separate divisions is affecting the commercial success of the business.[23]

None of these organizational and procedural deficiencies can be overcome independently of the others. Technical assistance to improve management information systems is ineffective unless parastatal managers are motivated to want more relevant and timely information. Why, for example, should they want to supply the NIB with more information than they give to their sectoral ministers when they are not sure whose supervision really counts? Why should they want to provide more detailed financial information to government unless they are subjected to stricter financial discipline? Why should they become more commercially-oriented when existing budgetary and regulatory processes are focused on inputs (mainly personnel and salaries) rather than on outputs?

Under these circumstances parastatal managers could be expected to adopt a "counterimplementation" strategy toward the performance contract system: lay low; rely on inertia; keep the system complex, hard to coordinate, and vaguely defined; minimize the implementers' legitimacy and influence; and exploit their lack of inside knowledge.[24] The delays in compliance with parastatal reporting requirements, the unwillingness of parastatal managers to assume responsibility for correcting problems identified in NIB's quarterly performance reports, and the drawn out nature of the negotiations themselves are consistent with this strategy.

One of the greatest threats to successful implementation of the performance contract system is that the information deemed to be necessary has been inappropriate and excessive. For instance, the principal consultant study recommended the following reporting requirement for PEs undertaking performance contracts, and these recommendations were duly included in the contracts: three year corporate plans, revised annually, including annual projected profit and loss statements, quarterly cash flows, capital expenditure programs, a wide range of performance targets and other key indicators; annual budgets with quarterly projections of revenue and expense for each major good and service produced; indicative 24 month forecasts, prepared annually, covering borrowing and capital expenditure needs. All of these were to be provided quarterly to the NIB.

Reporting requirements of this magnitude might strain the accounting and management information system capabilities of many major corporations. In the Gambian context in the mid-1980s, they were simply not reasonable. There has been confusion as to the limits of the contract performance process. The information requested did not distinguish between the need to hold parastatal managers accountable for results, to regulate the activities of the PEs, and the requirements for instituting and monitoring long term structural change. The result is that the performance contracts have imposed impossible reporting demands on managements, and have

been far beyond the NIB's capacity to monitor.

In business management an information system should highlight the tasks and decisions which are critical. Information that is uncritical and unexceptional is uninformative. Most of the information currently provided by parastatals to the NIB is uninformative in this sense. It has tempted NIB staff (and often succeeded) to spend valuable time checking the plausibility and consistency of the data. That is a regulatory responsibility which should be left to external auditors. It has played right into the hands of counterimplementation strategists by exploiting the lack of inside knowledge of those who are monitoring the organization.

The information that NIB requires to monitor the performance of parastatals under contract is similar to that required in a system of "management by exception." The NIB has neither the personnel nor the knowledge to second-guess management's operating decisions or to audit their accounts. The NIB should focus its attention on the difficulties parastatals experience in achieving expected results; and if there are shortfalls, it should pay special attention to the measures adopted by managers to correct the problems. Or, if shortfalls appear to be caused by factors beyond management control, the NIB should try to facilitate the adoption of other appropriate remedies or should notify government promptly about the consequences of unavoidable slippages.

In summary, the inadequacy of information for monitoring parastatal performance contracts can be attributed mainly to the lack of motivation to change the traditional relationship between government and its enterprises. In contrast with other parts of the public sector, government must rely on the parastatals themselves to provide the necessary information. To strengthen incentives for changing traditional relationships and providing necessary information, the supervisory roles of sectoral ministries, the NIB, and the president's office need to be clarified; government control of parastatal financial transactions (and of government agency transactions with parastatals) need to be strengthened; and government budgetary and regulatory procedures affecting parastatals should be given a much stronger commercial orientation. A stronger system of external auditing of parastatal accounts is needed to make it unnecessary for the NIB to become involved in this area.

6. Lessons from the Gambian Experience

The massive and continuing effort that has been required to reform the PEs raises serious questions about the wisdom of the original investments. No doubt, at the time each of the PEs was established, the benefits and costs were debated and some of the implications assessed. The main problem, however, has not been with the PEs <u>considered individually</u>. The main problem was the

failure by the government to recognize that the operations of the PEs, as a group, reflected an approach to economic policy which was unsustainable. Some economic inefficiency can be tolerated in any economy. Defense is a classic example. But no economy can withstand widespread underperformance and non-performance by the majority of its key organizations over long periods of time.

The basic story in The Gambia is that no one in the government paid attention to the macroeconomic effects of the collective impact of the PEs. However, as the adverse effects cumulated parastatal reform became essential.

The Gambian experience illustrates a number of points.

First, because of the interest groups involved, parastatal reform automatically faces considerable resistance. Even getting the problem on the government's agenda proved to be difficult and was not achieved without donor pressure.

Second, performance contracts and privatization are in principle highly desirable means of reforming PEs. The performance of enterprises that, for whatever reason, have to remain under public control can be enhanced. The government can rid itself of the administrative and financial commitments of organizations that are better suited to the private sector.

Third, the preparations involved for the implementation of performance contracts and privatization are lengthy, complex, and skill-intensive. They should not be made more so by having the monitoring agent make unreasonable information demands on the organizations involved.

Fourth, the agencies given the responsibility for promoting parastatal reform require special assistance. The authority and capability of the oversight agency has to be commensurate with its responsibilities. The objective should be to develop the capacities to facilitate privatization and monitor PE performance. The temptation to "police" the PEs has to be resisted.

Fifth, the role of the donors is critical. It is needed to overcome local resistance to the idea of parastatal reform, provide technical assistance to generate the performance contracts and monitor them, and support the government's efforts to value and sell selected PEs. Donor assistance has been critical in providing the finance needed to "straighten out the books" of bankrupt PEs and to provide managers to "straighten out the operations" of selected PEs. An issue for the future which has been bypassed in dealing with the problems of the present is how will the donors extricate themselves?

Finally, the problem of parastatal reform raises a broader issue of the role of the government in the economy. Although many Gambians

would agree that the government has been over-extended no mechanism exists independently of donor conditionality (which restricts the creation of PEs, limits external borrowing, and contains the growth of domestic credit) to determine the dividing line between public and private sector activity. It should be of some concern that there has been no debate about the issue in The Gambia. Such a debate is needed if the government is to be forced to confront the limits of its financial and administrative capacities.

Annex A: The Gambia's Public Enterprises, 1985 and 1990

A. Financial:	1985	1990
Central Bank of The Gambia (CBG)	100%	100%
Gambia Commercial and Development Bank (GCDB)	100%	100%
Gambia National Insurance Corporation (GNIC)	100%	0%
Government Saving Bank (Post Office)	100%	100%
Agricultural Development Bank (ADB)	100%	0%
Social Security and Housing Financing Corporation (SSHFC)	100%	100%
B. Non Financial:		
Gambia Produce Marketing Board (GPMB)	100%	100%
Gambia Utilities Corporation (GUC)	100%	100%
Gambia Ports Authority (GPA)	100%	100%
Gambia Telecommunication Company (GAMTEL)	100%	99%
Gambia River Transport Corporation (GRTC)	100%	100%
Livestock Marketing Board (LMB)	100%	100%
Fish Marketing Corporation; Fish Processing and Marketing Corporation (FPMC)	100%	0%
Atlantic Hotel	100%	100%
Citrus Products Company Ltd.	100%	100%
C. Partially Owned By Government		
Gambia Tannery Company (GAMTAN)	50%	50%
Seagull Coldstores Limited	61%	61%
Wing Africa Ltd	50%	0%
African Hotels (Sunwing)	33%	0%
Kombo Beach Hotel (Novotel)	20%	20%
Senegambia Beach Hotel	40%	40%
Banjul Breweries Ltd.	10%	10%
C.F.A.O. Supermarket Ltd.	9%	0%
National Trading Corporation	51%	40%
Standard Chartered Bank (Gambia) Ltd.	10%	0%

Source: Ministry of Finance and Economic Affairs.

Endnotes:

1. The Gambia Savings Bank, Gambia Oils Seeds Marketing Board, the Gambia Currency Board, and the Gambia Cooperatives Marketing and Finance Corporation.

2. For instance, GAMTEL was established when Cable & Wireless Ltd. was taken over in 1985. At the same time, the government attempted to set up the Fish Produce Marketing Corporation. That caused serious problems with the World Bank. At one point, continued World Bank support for The Gambia's adjustment program hinged on the whether the government would cancel plans to establish the organization.

3. The Cooperative Credit and Thrift Societies were formed in 1955; the GCCB&MU Ltd. was formally registered in 1959.

4. The plan noted that "...where it is deemed to be in the public interest, activities will be taken into public ownership or Government controlled institutions will be set up" (GOTG 1975:168).

5. World Bank 1985a:Table 7.1.

6. Examples include loans to civil servants, the purchase of the old Atlantic Hotel, and equity in Citroproducts Ltd.

7. Wing 1983; World Bank 1985b; Biggs et al. 1985.

8. The minister of finance discovered how potent when, in 1984, he attempted to use his authority under the GPMB Act to have an "efficiency audit" done of the GPMB. The Managing Director was directed by the GPMB Board to take leave during the process. He refused. Lacking support from the president, the minister abandoned the effort.

9. GOTG 1985.

10. The firms differ from those noted in the ERP. GPTC was in the process of rehabilitation and GAMTEL was operating profitably. GPA had few problems and a well-established management system. It was included because few difficulties were anticipated.

11. This presumes that the organization is privatized without offering its new owners tax incentives to "sweeten the pie". It also presumes that the new owners will in fact pay the taxes they owe. As several studies of the tax system have shown (see chapter 11), that cannot be taken for granted.

12. Vickers and Yarrow 1991:118-119.

13. The first sale of government shares were in CFAO Ltd. and Standard Bank in 1987. NTC was offered for sale in 1988. It was eventually sold in 1992. Organizations successfully divested during the ERP included the Nyambai sawmill in 1988 (for D4 million), and Gamtours in 1989 (for D1.4 million). A recent IMF report (Rumbaugh 1992:270) indicated that a major acceleration in divestment had occurred with more than 60% of the number of PEs having now been sold.

14. There was a hiatus in changing the law. A Public Enterprises Act, specifically designed to legitimize performance contracts, was not drafted until 1988.

15. For example, the government's attempt to restructure GUC's finances resulted in a long debate about the extent of the debt and whether the government had previously forgiven some portion of it. To make progress, the government accepted GUC's estimates (see chapter 15).

16. Ladd 1989.

17. The source of these off-shore deposits is open to speculation. There is little doubt that some of it has been related to illegal activity such as customs fraud. One dilemma in promoting privatization programs is that frequently the only people who have the financial resources and who are willing to assume the risks involved are those who have learned how to fiddle the system the most effectively. Indeed, The Gambia has had already had a case where a local entrepreneur, who has been one of the major customs and income tax cheats, purchased a large parastatal. That is, the entrepreneur purchased the parastatal with resources he stole from the government.

18. Revealed in the investigations of customs fraud in 1986, 1988, 1989, and 1992 and the 1992 report on income tax (Gray et al. 1992).

19. The sale of the NTC was delayed for more than a year because the NIB had valued its shares at book value <u>plus</u> the debt to government. Only the SSHFC, under pressure from the government, took up shares at that price.

20. USAID sponsored a consultant to review the case for a stock market in The Gambia (Ladd 1989). He concluded that it was premature.

21. This section draws on McPherson and Mallon 1990.

22. At least one PE has even earned interest arbitrage by financing the purchase of treasury bills with cheaper central bank credit.

23. This was clearly demonstrated by the case on the GUC (Murthy 1989).

24. See Keen 1981.

8

Monetary Policy and Financial Reform

James S. Duesenberry and Malcolm F. McPherson

1. Introduction

At the time the ERP was formulated, monetary policy was in disarray - inflation was accelerating, interest rates were highly negative in real terms, currency substitution and capital flight were major problems, foreign arrears were increasing, financial disintermediation was at an advanced stage, and the parallel foreign exchange had largely displaced the official market. Worse, the government had no effective means of conducting monetary policy since it did not know what the major monetary aggregates were until months after the fact.

Improvements in monetary and financial policies were needed. This chapter examines how The Gambia implemented what, in retrospect, have been a series of remarkably constructive changes in these areas.

This chapter has the following format. Section 2 reviews briefly the monetary and financial setting in The Gambia. Section 3 discusses the consequences of the ERP. Section 4 examines the changes in monetary and financial management under the ERP. Section 5 reviews some of the issues that need to be addressed if improvements in monetary management are to be sustained. Section 6 has concluding comments.

2. The Monetary and Financial Setting

As a small, open economy, monetary and financial developments both domestically and abroad have been crucial to The Gambia's economic performance.[1] On the positive side, access to international financial markets has opened up a rich array of high yield, secure financial instruments. On the negative side, adverse changes in the external financial situation require Gambian policy makers to respond appropriately in order to minimize damage to the domestic economy.

Many of The Gambia's monetary difficulties arose because policy makers did not respond in ways that maintained financial stability. There were two reasons. The first was the attempt to promote economic development through government intervention. The second was a policy of central bank accommodation which became more pronounced as the 1970s progressed.

The shift by the government to a more activist role in promoting economic development occurred over several years. It began with the establishment of the central bank in 1971 and the Gambia Commercial and Development Bank (GCDB) in 1972, and intensified with the introduction of the first five-year plan in 1975. Monetary and financial policies had two principal goals under the plan.[2]

They were the maintenance of financial stability and the provision of credit to promote development. There were obvious trade-offs involved and the plan provided no guidance as to how they would be resolved.

An accommodating monetary policy became possible only after the central bank was established. The Gambia Currency Board, which preceded the central bank, had rigid operating procedures. The currency issue was backed by foreign assets, limits were imposed on the Board's lending to the government, and loans from the Board had to be repaid within a specified period.[3] With these procedures the Gambian pound was fully convertible into sterling and consistency was imposed in economic management. Specifically, the monetary authorities could not attempt to control both the exchange rate and the money supply.[4] The central bank was free of these strictures.

a. The Financial System

Due to its low real income and uncomplicated economic structure, The Gambia has a simple financial system.

It consists of the central bank, three commercial banks, The Gambia Commercial and Development Bank (GCDB), Standard Bank Gambia (SBG), and the International Bank for Commerce and Industry (BICI);[5] a thrift institution, the Government Savings Bank, commonly referred to as the Post Office Savings Bank (POSB); four insurance companies; and the Social Security and Housing Finance Corporation (SSHFC). Financial services of various kinds have also been provided by two parastatals, The Gambia Produce Marketing Board (GPMB) and the Gambia Cooperatives Union (GCU), and three government entities, the Indigenous Business Advisory Service (IBAS), the National Investment Board (NIB), and Gambia Women's Finance Corporation. Several non-governmental organizations such as Action Aid have a financial component in their activities. More recently several *bureaux de change* have been established.

There has been little competition among the banks. BICI has a select clientele. Its loans and advances are less than 5% of the total so its behavior does not affect the volume and pattern of lending. GCDB has been in financial trouble for so long that it has lacked the resources to compete. The SBG has been selective about its customers and the terms on which it agrees to conduct business on their behalf.

By contrast, competition for foreign exchange business has been intense. Since the dalasi was floated in 1986, the rates quoted by the banks range within a few points and, with one exception (discussed later) are at levels which have undercut the parallel market. The entry of *bureaux de change* in 1990 intensified the competition.

b. Financial Markets

There are two formal financial markets in The Gambia - the interbank market for foreign exchange and the treasury bill tender. The parallel market for foreign exchange now operates semi-formally. The informal arrangements are discussed elsewhere (see chapter 9).

The interbank market which was established in January 1986 involves the buying and selling of foreign exchange at prices determined between each of the banks and their customers or among the banks and the central bank. With one major exception, when the central bank attempted to resist further depreciation of the dalasi in 1989 and 1990, this market has functioned well (see chapter 3). Since mid-1986, the exchange rate has been within a few points of the parallel market rate.

The treasury bill tender established in July 1986 has two purposes.[6] It provides financial institutions and individuals with access to high quality government paper as a means of absorbing excess liquidity. It also established a market-determined rate of interest which serves as a bench-mark rate for the whole economy.

The parallel market for foreign exchange became increasingly evident in 1981 as foreign arrears mounted and the central bank could not meet requests for foreign exchange.

There is no formal money market. None of the large firms or the banks has endeavored to lend their cash surpluses on a short-term basis. Some one-off transactions have been brokered by the central bank, but there is no formal mechanism for firms or individuals to trade financial assets. Most large operators find it easier to place their spare resources off-shore.

There are no active formal markets in bonds or equities.[7]

c. The Central Bank and Ministry of Finance

In The Gambia, there has always been a close formal association between the central bank and the ministry of finance. The first governor of the central bank, Sheriff Sisay, had been minister of finance from 1962 until 1968. When Sisay moved from the central bank to take over again as minister of finance in 1982, the permanent secretary of finance was appointed governor.

For several years after its founding, the central bank acted as though it had some autonomy. Gradually however, the ministry of finance began to prevail. The first indications appeared in the central bank Annual Reports of 1975/76 and 1976/77.[8] The government did not repay the short-term ways and means advances in the time frame required by the law. It also turned to the central bank for the first of several "temporary" advances to fund specific

development projects. Although they were classified as "bridge finance" designed to enable projects to proceed while donors disbursed the funds,[9] the loans became permanent because some donors did not disburse as expected and the funds which did arrive were diverted to other uses. In effect, the government began using the central bank for permanent rather than temporary financing. It was symptomatic of the erosion of financial discipline which was increasingly evident throughout the whole public sector.

3. The Consequences of the ERP

Despite the evident breakdown in the financial system and the worsening of the economic difficulties, the government had been reluctant to change its policy stance.

However, with the introduction of the ERP, the government began to regain control over the budget. The central bank reduced the growth of credit and the dalasi stabilized which helped the economy recover on a broad front.

The ERP represented a major break with past economic policies. Market-determined exchange rates and interest rates were established, effective limits were placed on the growth of domestic demand, a strategy for fully servicing the external debt was adopted, and purposeful measures were taken to eliminate external arrears.

Current economic policies in The Gambia, with their emphasis on fiscal responsibility, financial liberalization, and market-determined exchange rates, have provided a solid foundation for the conduct of future monetary policy. The key, however, will be the continued control over the public sector deficit.

With the return of financial stability, the Gambian financial system is in the process of re-intermediation. The treasury bill tender system is now well-established; there is some demand by non-bank customers in T bills and T notes; the volume of time and savings deposits has grown faster than GDP; the bulk of foreign exchange activity related to Gambian trade and commerce is handled through the formal financial sector; and new financial institutions have commenced operations. These developments have been encouraged by the payment of positive real interest rates on deposits, the attractive yields offered on T bills and T notes, competition in the foreign exchange market, and the progress in the government's efforts to improve the performance of the major financial parastatals.

Notwithstanding these improvements, asset-holders are still hedging their bets. Despite the sharp drop in inflation and the relative stability of the dalasi, all of the financial improvements have come at the short end of the spectrum. Private investment in long-

term ventures is minimal. The bulk of private investment in The Gambia is still devoted to wholesale trade and tourism, both of which are short-term. Even the recent expansion of specialty agricultural products requires little in the way of long term investment, especially when the tax breaks and duty waivers provided by government are taken into account. With yields on short-term assets such as T bills of close to 20% per annum inflation at roughly half that level and no major gyrations in the exchange rate, few investors need run the risks associated with long-term investment in real assets.

4. Monetary and Financial Management

The pattern of monetary and financial management in The Gambia reflects the influence of institutional factors, external changes, capacity constraints, the government's choice of economic objectives, and the policies chosen to reach those objectives.

a. Objectives of Monetary Management

Prior to the ERP, both the central bank and the government had many objectives in the areas of money and finance. Some of these were contradictory, compounding the economy's difficulties.

Under the ERP, the operational objectives of monetary management were consistent. This was ensured by the government complying closely with the IMF's approach to financial stabilization. That approach had several elements:

- a realistic (market-determined) exchange rate;
- positive real interest rates;
- control over public sector borrowing;
- a moratorium on new loan guarantees and non-concessional external borrowing;
- the decontrol of prices; and
- improvements in the efficiency of public investment.

These measures have been aimed at reducing the rate of inflation, accumulating foreign reserves, re-establishing The Gambia's international credit-worthiness, and promoting financial re-intermediation. The government has generally pursued these measures with only a few slippages.

Notably absent from the above is the use of credit and finance to promote development. Under the ERP, such an objective would have been redundant. Indeed, by using monetary and fiscal measures which stabilized the economy, the government and the central bank have done more to promote economic development since 1986 than they achieved during their decade-long experiment with financial intervention.

The renewed stability in the major monetary aggregates is evident in the data of Table 1.

b. Interest Rate Policy under the ERP

Although many changes have been made in re-orienting the central bank's policies, perhaps the most dramatic shift was the change in interest rate policy.

After many years of arbitrarily low interest rates, the government changed its course with the adoption of the ERP. In spite of the inflationary pressures posed by the adjustment to a floating exchange rate in January 1986, and the elimination of price controls and subsidies on important commodities, the dalasi stabilized and inflation began to slow in less than a year. The central bank's determination to restrain monetary growth and its move to a "market determined" interest rate policy played a major role in the stabilization process.

In these circumstances, it is hardly surprising that the treasury bill rate rose to 20% during the stabilization process. It has since declined to 17.5%. However, since the inflation rate has also declined, the real interest rate on treasury bills has risen significantly.

The treasury bill rate is a key interest rate in the system. The discount rate is set at 2% above the bill rate while the minimum deposit rate is set at three percentage points below the bill rate. With deposit rates of around 12.5%, the real rate is slightly positive.

Banks may, of course, pay more than minimum. They pay the minimum rate to most customers for three month deposits, and post higher rates for longer term deposits. Customers with large balances may negotiate higher rates. In particular, the GCDB has often found it necessary to offer a deposit rate equal to reserve deficiency penalties to the central bank. Thus, the bill rate is the marginal cost of funds to the GCDB and the opportunity cost of funds to the private banks which would have excess reserves if they did not buy treasury bills (see Table 1).

The bill tender is used by the central bank to absorb excess reserves of the commercial banks. It is the equivalent of an open market operation. The large volume of bills outstanding since 1986 serves to mop up the excess reserves which were created earlier by the various operations of the government.

c. Intermediate Targets and the Transmission Mechanism

The principal intermediate targets have been domestic demand and the exchange rate. By setting limits on the sectoral and aggregate allocation of credit and providing a profitable outlet for excess

Table 1 : The Gambia, Monetary Survey, 1980/81-1990/91

(Millions of dalasis; end of period)

	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Net Foreign Assets	-48	-102	-161	-255	-255	-585	-313	-176	-150	-146	143
Monetary Authorities	-32	-94	-135	-238	-258	-595	-333	-192	-156	-167	115
Foreign assets						11	98	256	232	282	553
Foreign liabilities						-607	-431	-448	-388	-449	-438
Commercial Banks	-17	-8	-26	-18	3	11	20	16	6	21	28
Net Domestic Assets						596	295	225	192	112	-67
Domestic Credit	210	242	331	370	378	501	326	256	242	175	58
Government (net)	51	78	165	196	179	100	-65	-37	-115	-115	-297
Public Enterprises						217	217	101	133	39	48
of which: GPMB						133	156	56	75	28	38
Private Sector	159	164	166	174	199	184	174	192	225	251	290
Revaluation Account						237	393	392	433	590	564
SDR Allocation (D mil)	-9	-13	-14	-20	-34	-19	-47	-47	-48	-57	-57
Money and Quasi-Money	86	99	132	137	183	227	327	394	427	500	584
Money (Cash & Demand Deps.)	57	59	80	77	96	130	192	222	235	282	334
Quasi-Money (S & T Deps.)	30	40	52	60	86	98	135	172	192	218	250
Other Items (net)	76	42	38	-22	-60	-311	-315	-314	-335	-471	-428
Reserve Money						60	123	145	165	192	225
Currency outside banks						50	96	108	119	155	169
Liabilities to commercial banks						-0	27	37	46	38	56
Liquidity of Commercial Banks											
Liquid Assets							102	151	145	182	210
Treasury Bills							47	90	103	143	116
Excess Liquidity							28	63	48	78	93

Sources: Central Bank of The Gambia Quarterly Bulletins, various editions
International Financial Statistics, various editions
International Monetary Fund, SM/92/111, June 2, 1992

liquidity in the form of T bills, the government has systematically lowered the growth of domestic demand. For instance, in the period 1980 to 1985, domestic credit increased by 106% and domestic demand increased by 19%. Corresponding data for the period 1985 to 1990 were 39% and 154% respectively. The relative reduction in domestic credit, in turn, has eased the pressure on the price level.

The central bank has influenced the exchange rate both directly and indirectly. The direct effect has been associated with the purchase and sale of foreign exchange. Since the government has been committed to fully servicing all of its non-rescheduable debt and accumulating official reserves, the central bank has been a large net buyer of foreign exchange.

To avoid major shifts in the exchange rate, the central bank has therefore had to rely on indirect measures. Interest rate policy has been crucial in this regard. By continuing to offer more T bills than the market can absorb, the central bank has kept upward pressure on the discount rate. As a guide, it has attempted to maintain a significant spread (of 5 to 7 percentage points) between the Gambian T bill rate and the equivalent rate in the UK. That policy has sterilized resources that might have otherwise been used to expand domestic demand. The policy also diverted resources into domestic assets thereby reducing pressure on the balance of payments.

These manipulations have enabled the central bank to achieve its reserve accumulation objectives without major movements in the exchange rate.

Because the Gambian economy is so open, the transmission mechanism for credit policy has been simple and direct. Prior to the float of the dalasi, interest rates and the exchange rate were highly distorted. Credit expansion led to a sharp reduction in the net foreign assets of the banking system as demand for imports increased beyond the economy's ability to export and the yields on foreign financial assets became more attractive than those on dalasi-denominated assets. Foreign borrowing and aid covered the resource gap until creditors and donors refused further support.

As the economy unravelled, two alternative channels of monetary influence emerged. An increasing volume of local transactions shifted into foreign currency and the bulk of foreign exchange began to be traded on the parallel market. These developments modified the effect of credit policy on the economy. Credit expansion increased the demand for local and imported goods and services. Because of the shortage of foreign exchange, the excess demand created pressure on the parallel exchange rate. The consequent depreciation of the dalasi raised the price of imports. The price of domestically produced commodities began to rise as well. In the cases where those prices were controlled (cooking oil, bread, and meat) rationing became more intense. Higher prices

led to a decline in real incomes which tended to reduce demand. As the shortage of foreign exchange intensified, many traders and individuals began to shift out of local currency. It became more convenient and less risky to use CFA francs or some other hard currency (usually US dollars) for transactions purposes.

The ERP changed the transmission of credit policy. The liberalization of interest rates increased the attractiveness of domestic financial assets. This took pressure off the exchange rate as asset-holders no longer sought an outlet in foreign exchange. Moreover, in order to reduce fluctuations in the exchange rate, the government took steps to avoid domestic credit shocks. In effect, the ERP provided a framework in which changes in the demand for and supply of credit operated through market forces. It also provided the government with the incentive to ensure that public sector activities would not lead to sharp changes on either side of the credit market.

d. Credit Controls and Monetary Programming

Credit controls had been the principal instrument of monetary policy from June 1980, when they were introduced, until September 1990 when the central bank shifted to a policy of reserve management. Until the ERP, however, credit controls had been ineffective. This is evident from movements in money and credit shown in Table 1.

These were three reasons. First, the central bank was unable to control its lending to the GCDB. Second, there were no effective limits on the level of government borrowing. Third, the central bank's data were incomplete and out of date so that monitoring movements in money and credit was ineffective.

From 1979 onward, the only two banks to expand their lending were the central bank and the GCDB. SBG and BICI essentially stopped lending. Their loans in June 1979 were D31.8 million; by June 1985, they were D29.1 million, which represented a real contraction of approximately 38%. Over the same period, the GCDB increased its loans and advances from D65 million to D135.5 million, a real increase of 42%.[10] That expansion was financed by a D51.2 million increase in deposits and D45.6 million credit from the central bank.[11]

Again, over the same period, total domestic credit increased by D250.4 million, a nominal increase of 197%. Of that amount, net credit to the government increased by D146.9 million, or 450%. The corresponding real increases were 149% and 402% respectively.

Thus, any controls on the lending by SBG and BICI were irrelevant. Moreover, ceilings on GCDB's lending were ineffective since most of its credit came from the central bank. But, even here, the credit granted GCDB was significantly less than credit to the government.

Control over bank lending to the government was achieved only after the ERP was implemented.

The third problem was that the central bank and the government generally had no idea of the aggregate and sectoral break down of bank credit. Without up-to-date information, it was impossible to adhere to a credit plan. There were two issues involved. Data on credit and money were regularly several months late. That situation only changed toward the end of 1986 when the government with donor support developed a monitoring system for staying abreast of the data (see chapter 16). Monetary programming in any meaningful sense was not done. Under the ERP, credit ceilings were typically derived by and agreed with the IMF. Any adjustments to those ceilings were ad hoc. Ceilings for individual banks were based on past levels of lending.

The recent change to indirect monetary control has required that the central bank staff become proficient in monetary programming. Guidance is still provided by IMF staff during their regular visits to The Gambia, but monetary programming though rudimentary and mechanical in many respects has become an essential aspect of the management of bank reserves.

e. Seasonal and Cyclical Patterns in Credit

As an agriculturally-based economy in a sub-region that has marked seasonal trading patterns, The Gambia has always experienced seasonal variations in the volume of credit and money.

The central bank, and the currency board before it, developed a variety of procedures for accommodating these seasonal movements. Key concerns in managing the seasonal patterns of finance were that the credit released has been: (i) used for the intended purpose; and (ii) the advances are retired in a regular manner.

Problems emerged in the late 1970s when large amounts of crop finance was diverted to other uses.[12] In order to improve its control over seasonal credit, the central bank introduced an "imprest system" in 1980. Organizations making use of seasonal credit were required to retire their advances fortnightly. Collection rates increased dramatically with no additional strain on the crop marketing. In the four years prior to the introduction of the "imprest system" less than half of the crop finance had been retired.

5. Improving Monetary Management - Pending Issues

Definite progress has been made in The Gambia toward a more market-oriented system of monetary management. The transition to a fully rationalized market-based system will be time-consuming.[13] Whether The Gambia needs to make the full transition can be periodically

assessed as the process unfolds. In the meantime, numerous issues remain to be addressed. Better data are needed, monitoring procedures have to be enhanced, new financial instruments have to be introduced, existing institutions require strengthening, and financial supervision has to improve. One of the most important requirements, however, is the need to maintain the economy on a stable growth trajectory.

In this section, we briefly examine some of these issues.

a. The Public Sector Borrowing Requirement (PSBR)

Significant reductions in the PSBR occurred under the ERP. The decontrol of prices allowed several parastatals, e.g. the Gambia Port Authority and Gambia Public Transport Corporation, to generate substantial profits. Restrictions on the activities of others e.g. GCDB and GPMB, prevented them from going deeper into debt.

For the government, the ERP has led to a reduction in the budget deficit.[14] After grants, the budget actually registered a surplus in 1988/89. In aggregate terms, the public sector is now less of a drain on national savings than it used to be. That will have to be sustained.

b. Alternative Instruments

Under current circumstances, any attempt by the central bank to influence the exchange rate or the interest rate, especially on the down-side, would undermine confidence.[15] For practical purposes, both the exchange rate and interest rate have to remain at or close to levels determined in the foreign exchange and treasury bill markets. Some discretion is available in central bank advances, especially now that the parastatal reform program has reduced the necessity for the central bank to cover public sector losses through the GCDB.

However, that discretion is limited by the continued existence of excess liquidity in the commercial banks (Table 1). A review of the level and trend in other components of the central bank's balance sheet indicates that it has little discretion over any of them under current conditions.

For the central bank to systematically change the level of reserves in the economy, its main policy instrument is the purchase and sale of treasury bills. These have a direct affect on the government's deposits. Indeed, for the foreseeable future, the central bank will depend on the T bill market to influence liquidity and ultimately bank reserves. The unfortunate experience with the G-bill issue will make it difficult to issue other debt instruments.[16]

c. Appropriate Supporting Policies

In order to encourage financial development (in the sense of a steady accumulation of a wider variety of financial assets with progressively longer maturities), a major requirement in The Gambia is confidence. Like creditworthiness and trust, confidence is a mercurial concept. The "objective" facts provide reason to be optimistic. The most obvious fact has been the solid economic recovery since early 1986. Yet, there is a deep-rooted suspicion that despite improvements in economic conditions and changes in government policies, the situation could unravel.

An important means of building confidence is to emphasize the reintegration of parallel markets.

The rapidity with which the gap between the parallel and formal foreign exchange markets closed in 1986 was a practical demonstration of the potency of price decontrol as an equilibrating mechanism. The re-emergence of the gap in 1989 when the central bank attempted to re-fix the dalasi, however, was a warning that financial channels which developed during the period of dislocation before the ERP have not disappeared. The same applies to any shift in the external deposits held abroad and the willingness and ease with which farmers can move their produce (rice, groundnut, millet, livestock) into Senegal in response to price differentials.

The continued integration of official and parallel markets will depend on the incentives created by government policies. Donor conditionality has been important in sustaining these incentives. For instance, wage costs were limited by the IMF program, there was a moratorium on external non-concessional borrowing, and the government's ability to provide subsidies was limited. To continue these initiatives, the government and the central bank will have to move from donor-imposed constraints to a policy of self-restraint.

d. Potential Emergence of New Institutions

Because of improvements in the Gambian economy, some new financial institutions have been established. A private insurance company, was set up in 1986. Since early 1990, several *bureaux de change* have begun operations.

The potential for other institutions has been explored. These include an organized stock market, one or more additional commercial banks, finance houses, and facilities for off-shore banking.

Although domestic savings are too low and the legal and institutional framework is too fragile and unpredictable to support a stock market,[17] some potential may exist for a finance house (or investment bank).

Whether any new financial initiatives succeed will depend on the demand for the services offered and their quality. Past experience has shown that government sponsorship of financial activities do not create viable institutions. Recent experience, however, suggests that government initiatives based on market-oriented policies e.g., the T bill market, can succeed.

e. Supporting Legal Framework

The legal system in The Gambia offers little support to the financial sector.[18] Both the government and the public enterprises have cut many legal and procedural corners. Though some laws are out of date and could be revamped, the problem is not the law as such. Neither the letter nor the spirit of the law is regularly observed and there are no internal mechanisms to change that.

In its present form, the legal system is a serious impediment to the promotion of additional financial instruments, such as bonds, mortgages, and debentures. Potential participants recognize that there is a low probability that contracts can be enforced through the courts. This raises the risks involved in any long term transaction. In the interim, asset holders maintain a short planning horizon and provide credit only on the basis of long-standing relationships and/or readily recoverable collateral (such as compensating balances, or goods-in-transit).

Several donor initiatives are under way to strengthen the legal system. Without leadership from the president, however, there will be few constructive changes. Attitudes to the law have to change. No law can mandate that.

f. Increasing the Autonomy of the Central Bank

A principal cause of the financial imbalances in The Gambia has been imprudent public sector behavior. With the improvements made over the last several years, attention has shifted to ways of preventing a recurrence. One suggestion is that the central bank should be granted more "autonomy", if not made "independent".

There is much muddled thinking on the issue. Central banks gain their status through special legislation. Governments can readily change that legislation should the bank attempt to be behave too independently. Moreover, it is simply naive to believe that a central bank could be truly independent of any government in Sub-Saharan Africa.

It is also too convenient to attribute the blame for The Gambia's economic difficulties to government policies. The central bank bears a substantial part of the blame. Its belated action on interest rates (and then only under pressure from the IMF) and its resistance to devaluation of the dalasi - even when it was clear that the foreign debt situation was out of control - were major

mistakes. Allowing its accounting system to collapse in 1988 was another serious error.[19]

A major overhaul of the management and operations of the central bank itself is needed. Some progress has been made over the last couple of years. Yet, more has to be done if the central bank is to earn itself a role in the formulation and implementation of economic policy.

g. Financial Supervision and Bank Examination

In The Gambia, financial supervision formally became the responsibility of the central bank with the passage of the Financial Institutions Act of 1974.

The bank examination units' reports have been of high quality. They have identified the major problems and made useful recommendations. A report on the GCDB in 1983 highlighted the bank's difficulties and recommended numerous measures for dealing with them. The report was suppressed by central bank management. Central bank examiners also recommended that the Agricultural Development Bank not be granted a license. That, too, was ignored.

Bank examination will only become a meaningful activity when the reports are seriously considered and acted upon.

h. Increasing the Rewards for Investment

In his mid-term review of the ERP, the minister of finance noted that perhaps the most important challenge facing The Gambia was to improve productivity.[20] Since productivity growth has been low, sustained economic growth would require major improvements in the efficiency of resource use.

Several changes in financial policy under the ERP have helped. First, higher interest rates have discouraged low productivity investments. Second, as part of its public investment program, the government has been committed to using specific criteria to raise the returns on its investment. Third, greater attention is being paid to the management of development projects by both the funding agents and the government. Fourth, the reorganization of the civil service has had some effect on the performance of the public sector.

Nonetheless, the ERP has been criticized for the fact that the interest rates needed to stabilize the economy greatly exceed the rates at which long-term investment will occur. Over the medium term, this imbalance will become less pronounced as more resources are mobilized and their allocation is improved. In the short-term, there is little that can be done to "force" interest rates down.

This constraint has not stopped government and central bank officials from calling for specific measures to lower long-term interest rates.[21] The emphasis on long-term investment distracts attention from the need to raise the efficiency of resources use. Economic growth can be promoted just as effectively through a series of high productivity short-term investments. In view of the financial disruptions of the last two decades, that option may be the best available. Private long-term investment in The Gambia is simply too risky at present to attract capital.

Indeed, the argument can be reversed. The Gambia attempted to promote growth using long-term investment financed by cheap foreign aid. The costs of that failure will take decades to work off.

That experience, supported by a large volume of international evidence as well, shows that cheap credit policies do not work. If, however, the government wants to subsidize particular activities it should be done through the budget, not the financial system.

i. Dealing with Contingencies

With The Gambia now attempting to influence the path of money and credit by control bank reserves, an important issue is what measures are needed to deal with external and internal developments which may potentially disrupt the financial system. For example, a drought may lead to a sharp drop in export receipts and increase the demand for imported food. The resulting pressures on the balance of payments and exchange rate may boost inflation. It would also result in a loss of reserves which could affect confidence. Alternatively, the budget deficit may increase sharply because of wage adjustments, higher levels of recurrent expenditure, or a collapse of revenue.

To prepare for disruptions of this type, the ministry of finance and the central bank should jointly consider some alternative policy responses. Once a crisis is underway it is often too late to do this. Furthermore, disputes may arise about an appropriate policy response. These should be highlighted in advance.

It will be impossible to anticipate all contingencies in advance. That, however, is not the object of the exercise. The idea is to have a mechanism in place for co-operatively dealing with contingencies.

j. Aid Dependence

The introduction of the Programme for Sustained Development (PSD) in 1990 revived the notion which the ERP had sought to dispel, namely that the principal way to accelerate The Gambia's growth rate was access to additional external resources.[22] The re-emergence of this fallacy is unfortunate. The lessons of The

Gambia's earlier experience with aid seem to have been lost.

Foreign aid was the explicit mechanism whereby development was to be promoted in The Gambia's first and second five-year plans as well as the mid-term review of the second plan.[23] The reality is that since 1986, The Gambia has received external assistance equivalent to more than 40% of GDP.[24] The economy revived and the external arrears were paid off. Aid on that scale is unlikely to continue.

Few policy makers seem to recognize the point. Indeed, one lesson that senior policy makers in The Gambia seem unwilling to accept is that economic development, i.e., sustained improvements in income and welfare, do not result from additional aid. They require the mobilization of domestic resources and major improvements in the efficiency with which those resources are used.

6. Concluding Comments

The Gambia has made impressive progress in stabilizing its economy and providing a foundation for sustained economic growth. In that sense, the ERP was a major success. The challenge for the future, which is an explicit goal of the PSD, is to maintain the momentum. Financial reform will continue to be vital to that effort.

Major improvements have been made in the financial area. Institutions have been rehabilitated, market processes are now used to control reserves and money supply, and interest rate policy has been improving the efficiency of resource allocation. Overall, the major financial and economic imbalances have been reduced and a coherent framework now exists for continued economic growth.

Nonetheless, the rate of improvement has been constrained because few people are confident that the changes made so far represent <u>reforms</u>, in the sense that both policies and behavior have been fundamentally transformed. Because of the extent and sources of the financial disruptions in The Gambia over the last two decades, it may take years for that perception to change.

In the meantime, the government has no option other than to persevere with a purposeful program of strengthening economic management and the institutions through which monetary policy is implemented. To do otherwise risks a return to the economic retrogression of the early 1980s.

During the period when the economy collapsed, Gambian policy makers had a clear lesson that financial imprudence and economic growth were incompatible. With the introduction of the ERP, they began to learn that prudent financial policies do not guarantee sustained economic growth. With the ERP behind them, they now have to learn how to sustain the momentum in financial reform. That will be a

major challenge. Improvements in monetary management through the market-based control of bank reserves is a useful start.

The over-riding question is whether a permanent transformation in The Gambia's financial policies has actually occurred. The ERP successfully halted the economic decline and the foreign arrears have been cleared. This, however, required massive foreign aid. That so many resources have been needed to turn the country around, reflects the depths to which the economy had sunk. But, it also reflects the fact that Gambians themselves have not been prepared to supply many of the resources needed to rehabilitate and develop the economy. (The large deposits held offshore are clear evidence of this point.) A basic question which has significance for the long term development of the country is: if Gambians will not now use their own resources for economic development, when will they?

In the past, the government has been the investor of first and last resort. That strategy failed. Resources were wasted through mismanagement and inefficiency, the limited supply of national savings was dissipated, and public resources were diverted for personal and partisan purposes. Financial reforms can do little to overcome these problems.

Endnotes:

1. McPherson 1979:Appendix 3.

2. GOTG 1975:Ch.7; Ibid.:4,31,45c,47,49,67,97,104,109,149.

3. The Board:

- maintained a ratio of external reserves against currency and demand liabilities of 50%;
- discounted and rediscounted bills and promissory notes against prescribed security for a maximum of 120 days;
- limited outstanding advances to Government to less than 10 percent of the estimated current revenue; and
- limited government advances to a single fiscal year. (The Gambia Currency Board Final Report 1971: 4-5).

4. With a fixed exchange rate, the money supply is endogenous (Niehans 1984:267-271, Gleske 1987:19). An economy with The Gambia's structure cannot fix its exchange rate and sustain an independent monetary policy. Although this point was understood by central bank staff (cf. Bajo 1978:106), they made the attempt nonetheless.

5. Continent Bank exists as well. See note 28 below.

6. Duesenberry 1986.

7. Ladd 1989.

8. The turning point was 1974/75. In the Budget Speech of that year, the minister of finance announced, with evident pride, that the government had repaid its advances fully to the central bank as required under the Central Bank Act. No such announcement appeared in subsequent years.

9. These central bank advances were mainly to support the expansion of the Yundum airport. The "temporary" advances, which began in 1976, were eventually repaid by the government in 1987 using counterpart funds sterilized under the IMF program.

10. Ladd 1989: Exhibit 6.

11. A common perception among senior Gambian officials is that the behavior of SBG and BICI has been exploitative. They base this on the high profits earned by the banks, the loan concentration by sector, the short-term nature of their portfolios, and the selection criteria applied to determine types of customers and ventures which they consider "bankable." A major reason for setting up the GCDB and the ADB was to break out of this "colonial" pattern of lending. One of the goals was to provide long term finance so as to "promote development". These banks failed largely

because they were unable to mobilize the resources needed. Their potential creditors (those holding deposits or bank bonds had similarly concluded), like those who managed the SBG and BICI, that long-term lending in The Gambia was "bankable" either.

12. Part of the initial unravelling of the financial system in The Gambia resulted from a major reversal of seasonal patterns in credit. Between March 1978 and September 1979 the pattern of bank loans and advances was contrary to the normal seasonal factor. This produced a major, unprecedented, real increase in bank credit.

13. The case of Australia is instructive. Its financial liberalization was as rapid as has occurred anywhere. Yet, even though it already had a solid institutional base the liberalization program required approximately five years to prepare and implement (Johnson 1985).

14. If allowance is made for extraordinary transfers. These included the subsidies to GPMB for groundnut price support, and transfers to public enterprises (GUC and GCU) to rationalize their debts.

15. The central bank could always choose to raise interest rates above market clearing levels as a means of forcing the mobilization of savings. It could also push the dalasi to the point where it was undervalued as a means of enhancing The Gambia's competitiveness and accumulating foreign exchange. Such a break with past behavior in The Gambia is unlikely.

16. G bills were an attempt to develop a seasonal financing facility for groundnut marketing. However, when they were first issued in 1990, the GPMB could not redeem them in full. In effect, G bills became an indirect means of having the central bank finance GPMB.

17. Ladd 1989.

18. Deloitte and Touche 1990.

19. The problem arose when two parts of the bank had different values for foreign assets. The datum was critical to the IMF program since the accumulation of reserves was a performance criterion. The problem was only solved when the governor of the central bank was fired and the ministry of finance helped the central bank staff its accounts to find the missing resources.

20. GOTG 1987.

21. In making this call, the point is always conveniently overlooked that real interest rates in the informal sector of the economy have always been above the levels that were considered to be too high.

22. GOTG 1990.

23. Contrary to the theme of the first plan, te sito, or self-reliance. Indeed, as The Gambia has become more dependent on foreign aid, that theme was dropped.

24. In per capita terms, The Gambia is already one of the highest aid recipients in SSA (World Bank 1989b:Table 18).

9

Rural Credit and Savings

Paul E. McNamara and Parker Shipton

1. Introduction

The Gambia's economic difficulties were accentuated by the government's rural credit policies. The Gambia Cooperatives Union (GCU) which was the governments principal means of disbursing credit in the rural areas focused almost exclusively on providing low interest loans to farmers. The GCU gave little attention to collecting its outstanding loans; and even less attention to the mobilization of savings.

Over the years, the government has devoted a large amount of national resources to subsidized rural credit. Despite this investment little formal study of rural credit and savings has been undertaken. Where analyses occur, they typically approach the topic from the formal sector point of view.[1] To overcome the biases associated with this approach, a concerted attempt was made in 1987 to understand rural finance from the farmer's perspective.[2]

The shift in orientation was important for it provided policy makers with information suggesting the many of their presumptions about the credit "needs" and sources of credit and savings in rural Gambia were false. Farmers have "needed" credit and have not been adverse to accepting it from government agencies. Nonetheless, those "needs" are part of a broader pattern of social and economic relationships which do not attach a high priority to the continued viability of the government agencies which provide them with credit.

This chapter attempts to throw some light on that situation by telling the story of how reforms introduced under the ERP influenced rural finance. Section 2 describes the cultural economy of rural credit and savings in The Gambia. Section 3 examines the role of the GCU in providing finance and how that role was affected by the ERP. Section 4 discusses the reform of rural financial policies follows and draws lessons for policy makers. Section 5 has concluding observations.

2. The Cultural Economy of Rural Credit and Savings in The Gambia[3]

Informal systems of saving and credit in rural Gambia are pervasive, diverse, and fairly flexible, and they take many forms not usually noted in "financial sector" reviews. They include widespread lending of land, livestock, labor, tools, seeds, and money, informal rural (and urban) deposit-taking, village men's and women's groups, rotating savings and credit associations of various kinds, religious exchanges, delayed marriage payments, family investment in labor migrations, and re-selling of hard household goods. While many of these practices may not be construed as directly or immediately "productive", they often contribute indirectly to production, and to kinds of consumption that make production possible. Farmers unassisted by governments,

cooperatives, or banks are neither without credit (as some reports would have it) nor entirely at the mercy of "moneylenders" (as others would have it). The institutional systems based in Banjul are only a small though important part of the picture in the villages.

a. Rural Lending

Resources of nearly all kinds are lent at local levels, and some are lent over long distances or between Gambian hosts and international migrants. Gambian farmers live in a credit economy: most are perpetually involved in a complex web of debts and credits to relatives, neighbors, friends, and merchants. Farmers have their own personal hierarchies of creditors and needy others; and that the newest, most distant, and least familiar lenders rank at the bottom. This too may indicate a hazard to potential lenders, or seen another way, a gap to be filled.

Rural Gambians' own "informal" loans vary greatly in duration. Debts involved in marriage or in major livestock loans may sometimes last longer than a generation. Aside from family investments to send young migrants away for schooling or work, nearly all the existing indigenous money lending is for periods shorter than a year. Much of it, in small-scale trade for instance, occurs on the basis of weeks, days, or even hours. Interest charges levied on longer-term loans are problematic not only for borrowers, but also for lenders, because of religious proscriptions locally interpreted as forbidding high interest rates <u>or</u> ratios of interest to principal as finally paid. Agricultural credit for heavy machinery, fruit trees, and other purposes requiring several years or more is virtually non-existent.

The tightness of money in the rural areas, and the embeddedness of most cash lending in social relations, attest to the difficulty of lending money in The Gambia. Just as the members of a rotating contribution club know each other intimately and have many ways to sanction one who fails to cooperate, any institution that enters the financial picture must know a certain amount about its borrowers, or must find ways to rely on their mutual interactions and pressures among themselves to keep the system running.

In arranging their own <u>ad hoc</u> loans of land for labor, tools for seed and radios, etc., farmers show that local credits and debts are flexible things, often repayable in forms other than those initially issued, and often renegotiable. Money sometimes enters these agreements, sometimes not. "Finance" is not a discrete sector of life. As farmers see it, there is no reason why "formal" loans from cooperatives or international agencies should not be passed on to kin or neighbors as "informal" loans or gifts, or why borrowed groundnut sacks should not be used for roof repair or bedding. "Sectors" like agriculture, housing, trade, or industry simply do not mean as much to rural people as they do to agency or

government planners. People do not live in sectors.

The functions that government lenders have lately served - chiefly, providing groundnut inputs and tools, and cash amounts over 100 dalasis for farming - are quite specialized within the broad context of rural financial processes in The Gambia. The government cooperatives have captured much of the groundnut seed and fertilizer markets, though borrowers distribute some of these inputs further by loans and sales between and within families. Farmers have grown reliant on the cooperatives to provide these things, but they do not find the cooperatives reliable enough. Similarly, the money lending of the cooperatives is appreciated, but farmers find it too sporadic. Cooperative cash loans are bigger than most "informal" seasonal cash loans, and it is hard for farmers to find such amounts elsewhere without paying steeper interest charges. But farmers know there is a price. These loans are used as mechanisms of political patronage and control, and cooperative loans engage farmers in local or national structures of authority and obligation. As everywhere, farmers know that if they are not made to repay their loans in cash or groundnuts, they will be expected to repay them in votes or campaign cheers. There is no credit without debt, and neither is credit or debt a simple economic transaction.

Farmers obtain loans of money from many sources, though most of the sources lend only small amounts. Relatives, neighbors, and friends are the most common, particularly for very small or very large amounts; shopkeepers and other traders also lend. Among the institutional lenders, the cooperatives are the major lending source for men in the rural areas. In the 1987 survey, 68% of the men interviewed stated they had borrowed money in the previous 12 months. Of those who had borrowed amounts significant enough for them to mention, 57% had borrowed mainly or exclusively from the cooperatives. Of the remainder who had borrowed, 35% had borrowed from kin and 65% from non-kin. Of these same male informal borrowers, 35% had borrowed from merchants and 65% from farmers who were not merchants, including a district chief and a marabou.

Of the women interviewed, 10% said they had borrowed money in the previous twelve months. Of these, not one said she had borrowed directly from a cooperative society; all reported having borrowed from neighbors, friends, or relatives. Of these women borrowers, three had borrowed from kin and four from non-kin. Three of them had borrowed from merchants, and four from farmers who were not merchants. Of these last four, one had borrowed from a kafo group.[4] Probably more men and women had borrowed money informally than reported having done so. And, more borrowing and lending occurs after bad seasons than after good seasons like the one which preceded the survey.

Land, labor, and livestock are usually lent only informally. Available sources include relatives, friends, neighbors, village

headmen, kafo groups, and "strange farmers" (migrant share contractors) or strange-farmer hosts. Most of the mechanisms for lending and sharing these things are deeply embedded in local social organization and overlapping rights in these resources, and these rights change in character seasonally. Access to these resources is thus not easily understood in conventional economic terms.

Farmers obtain hand tools like hoes from local blacksmiths, often on loans which take the form of customary gifts with the tacit expectation of a return in kind later, after a harvest. This form of credit, however, is yielding to cash sales. Animal-drawn tools including ploughs, seeders, and mechanical hoes are very commonly lent between relatives and neighbors, and from hosts to "strange farmers" for several days at a time, often as part of arrangements where other goods or services are provided in return. But borrowers usually have to wait until the owners are finished with them, and this often means planting or weeding late. For permanent procurement, there are no significant informal channels for loans to purchase implements. The cooperatives have issued animal-drawn tools and carts on medium-term credit. Private voluntary organizations (PVOs) have issued these in places as loans, grants, or both, and they are beginning to experiment with partial loans for heavy machinery like oilseed crushers. But neither the cooperatives nor the PVOs appear to be satisfying farmers' demands for animal-drawn or power-driven farm machinery.

Groundnut seeds are available on loan from the cooperatives, relatives, neighbors, and occasionally traders. The cooperatives have become by far the most important institutional source, normally lending amount between 50 and 300 kilograms per borrowing farmer.[5]

The survey for the 1987 study found that 57% of the men interviewed had borrowed groundnut seeds from outside their compounds in the preceding 12 months, and that of these, 97% said they had borrowed mainly or exclusively from the cooperatives. Among the women, 7% said they had borrowed groundnut seeds from outside their compounds in the preceding 12 months. Of these (five women), only one said she had borrowed directly from a cooperative.

There appears to have been less private borrowing in 1986 than in other years because the 1985/6 harvest had been a good one. But it is clear that the cooperatives are a most important source of groundnut seeds on loan, especially for men. Farmers count on being able to receive cooperative loans directly or indirectly. In the spring of 1987, before cooperative loans were due to be issued, many farm families began consuming their own stored seeds in the expectation that cooperative seed loans were forthcoming.

"Strange farmers" who borrow seeds usually rely on their hosts for these, commonly repaying the double at harvest. According to the

1983-4 national Agricultural Survey, 43% used their own seednuts, 37% borrowed, 17% bought, and 6% received them free from others.[6] Farmers who lend to others or labor for them may be compensated in seed upon the harvest, particularly if their own harvest has been poor.

Little formal borrowing and lending occur in seeds other than groundnuts. Relatives, friends, and neighbors are the usual sources of seed loans in the other crops. PVOs issue seeds for new crops (European vegetables, and sesame), together with other assistance, on various bases including interest-free loans, grants, and mixtures of the two.

Fertilizers are available to farmers almost exclusively from the cooperatives, the exception being the special projects of the Department of Agriculture or, very occasionally, those of other agencies.[7] Men farmers sometimes re-lend and sell borrowed fertilizer. The market is more limited, since only well-off farmers can afford to buy fertilizer in the summer months when cash is scarce. Pesticides are not normally available to farmers on loan. Spraying and dusting services have been available from the Crop Protection Service of the Department of Agriculture.

b. Rural Savings.

Similar to lending, rural Gambians save in a variety of forms. The diversity and complexity of rural savings have their own rationales, and currency instabilities make it sensible to put savings into other forms. Saving, like borrowing and lending, is an integral part of social life; and any institution that becomes involved in Sahelian rural finance is also involved with networks of kin, neighbors, and age-mates.

It is untrue, as sometimes said, that rural Gambian do not carry over wealth from year to year. But most of what they do save over periods of years is in non-monetary forms. They choose these forms for many reasons: to avoid inflation or political and regulatory control over their assets; to gain the benefits of milk, manure, and traction that animals provide, or to gain increases through livestock breeding; to consolidate their savings into indivisible forms or forms their relatives may help keep them from spending rashly; to avoid guilt associated with overt interest earnings; and to cut their losses to collapsing banks. Diversifying savings into many forms means reducing risks. It also means keeping wealth less conspicuous, both to other local people and to tax collectors. There is obviously sense in these strategies, even though the means of saving that farmers choose provide them sub-optimal earnings in monetary terms.

It is also untrue that Gambian farmers are uninterested in monetary savings. The <u>kondaneh</u> boxes,[8] the rural deposit-takers, and the requests for infrequent wage payments all testify that many rural

people want ways of saving cash. So too does rural peoples' liking to convert small notes to large ones (as men try to convert small livestock to large stock). While some economists assume farming people to have a "liquidity preference", these patterns indicate the opposite, an "illiquidity preference".

Part of the reason why rural Gambians seem to save so little of their wealth in money is that there are social pressures against hoarding during times of general scarcity. Group savings approaches are consistent with that principle whereas individual approaches are not: they make it possible to save without appearing selfish.

The rural financial mechanisms working least well are those designed for credit only. It has been the habit of most large and small development agencies with resources to dispose of, to look for ways to lend, rather than to examine local resources that might be mobilized, or to do both. Rural people consider most of the resulting credit projects to belong to someone else: the capital city, the government, the whites.

By contrast, in The Gambia as elsewhere in Africa, the credit systems that appear to be working most smoothly, like the informal osusu groups, appear to be those that incorporate savings and link them with lending. Savings in the osusu are the same as credit (the same transaction functioning as one or the other, for different members at different times). The groups embody several other sound principles: local initiative and capital, character screening by members, peer group pressure as the main means of enforcing co-operation and repayment. Osusus spring up by voluntary initiative in rural towns and villages, as in cities. Although some suspend operations seasonally, some last well over a decade, and as they dissolve, new ones form. Rural people consider these systems their own.

These observations suggest an incorporation of savings components in credit programs wherever the institution in question is financially sound enough to merit farmers' investment, and wherever it can build upon existing social networks. Much remains to be learned about how, and whether, financial institutions can emulate the financial principles observed already working in the rural areas. Whether savings and credit are linked or not, however, farmers clearly need some of each, and in a better mixture than they have them now. In the long run, credit and debt without saving can scarcely serve farmers' interests. Rural Gambians seem to be saying they need balance in their financial lives: between saving and credit, between liquidity and illiquidity, and between individual and group action.

Unfortunately, the government-sponsored financial programs have not provided this balance. If anything, they have tended to add to the imbalances.

3. Government Sponsored Rural Credit Programs

Since the mid-1970s, when the government began subsidizing rural credit on a large scale, its programs have been a succession of failures. A principal cause has been that the programs were conceived of and implemented as external interventions. They had little regard for the factors which influenced farmers' financial behavior or the motivations for, and constraints upon, their credit and savings activities.

By taking this approach the government overlooked some essential features of finance. First, the demand for credit is a derived demand. It is derived from the opportunity for productive investment. Subsidized credit does not create those productive opportunities.

Second, farmers require financial instruments which have high yields, low risks, are secure, and (notwithstanding the earlier comment about "illiquidity preference") are liquid.[9] With no attempt by the GCU to mobilize resources on terms that were judged to be attractive, farmers sought other opportunities. In doing so they tended to favor relationships which minimized the information and transaction costs involved in creating and maintaining instruments suitable for credit and savings.

Third, the government-sponsored intervention hindered the development of rural financial markets. These markets, when functioning normally, serve a number of useful purposes.[10] For instance they:

- ration finance according to the borrower's willingness to pay;
- allocate the finance to its most productive use(s);
- allocate demand among financial instruments;
- stimulate the release of real savings in financial form;
- reward the factors employed in financial intermediation;
- provide incentives for the expansion of the financial sector;
- provide a systematic basis for the evaluation of risk and the transformation of risk-bearing activity over time.

By rationing the supply of credit through quantity controls rather than price (interest rates) institutions such as the GCU have undermined the long term development of rural financial markets. The ultimate cost is reduced efficiency and lower rural welfare. The more immediate cost is that farmers and the institutions have little to fall back on when subsidized credit programs are eventually abandoned.

None of the government's initiatives in the area of rural finance, whether through the Agriculture Development Bank, the GCU, or the GCDB, addressed these basic requirements in terms to which farmers could relate. Institutional finance was provided to farmers primarily in response to the prevailing view that farmers "needed"

it and that only the government would provide it on non-usurious terms. It should not be overlooked, however, that politicians and those who sponsored the programs were also aware of the political advantages of having farmers depend on the government for finance.

Because the focus on credit "needs" placed little emphasis on finance and credit as economic resources, the government-sponsored loan programs were mismanaged and, in numerous cases, subject to fraud. As the following discussion reveals, the credit programs of the GCU were unsustainable interventions that continued to have a negative effect on the economy throughout the ERP.

The GCDB has never attracted significant deposits from rural people or undertaken an important loan program with villagers. The link between the GCDB and rural finance is through the GCU. By mid-1985, many donors and government policy-makers realized that the relationship between the GCDB and the GCU was an important source of economic instability. The GCU repeatedly borrowed funds from the GCDB without repaying them, adding to the sharp expansion of credit in the economy. But more importantly, credit markets had become politicized and through its access to GCDB funds the GCU had achieved a dominant position in groundnut marketing and input distribution.

a. The Gambia Cooperatives Union

Begun under the colonial government in 1955, and placed under the umbrella of a national union in 1959, the cooperatives have grown to assume a major role in the Gambia's rural lending, as well as marketing.[11] With a total membership (active and inactive) of about 100,000, the cooperatives in The Gambia have one of the highest rates of participation, in relation to population, of all government cooperatives in Africa.[12] Often several members of a residential compound belong. The GCU and its constituent primary societies have become the largest lender of groundnut seeds in the country, and the only channel available to farmers for obtaining fertilizers, which they both lend and sell for cash. They have also lent money and farm implements like ploughs, tine hoes, and donkey carts. In 1987/88 the cooperatives charged 24-26% nominal annual interest for seasonal credit, with a penalty for arrears.[13]

The GCU illustrates the main problem faced by a government-controlled credit organization in The Gambia - political interference in its management and operations. Although it is technically a member-owned and controlled cooperative, the GCU has been controlled by the government since the mid-1970s. The GCU became insolvent in the late 1970s due to blanket forgiveness of subsistence credit loans during the years of 1979 and 1980.[14] Throughout the 1980s, the GCU used its overdraft account at the GCDB and financing from the GPMB as well as project financing from the Rural Development Project I (RDP I) and the Agricultural Development Project II (ADP II) to extend credit to its members

(and in the case of the RDP I and ADP II, non-members). To date borrowers have repaid little of this credit. By early 1988, the Cooperative Primary Marketing Societies (the village level units) owed the GCU D76m.[15] In effect, the GCU's credit program became an off-budget transfer to selected members of the rural population. With the imposition of government control, the GCU ceased being run as a viable rural credit enterprise.

That was not always the case. From 1956 to 1970, the GCU's credit program operated smoothly, with repayments on its subsistence loans averaging 97%.[16] Subsistence loans were mainly small amounts of credit used to purchase food during the "hungry season". The success over that period can be attributed to the small, focused nature of GCU's lending operations: seasonal loan secured by groundnut sales; the unwillingness of the government to interfere with GCU's operations; and the generally high standards to which GCU's management was held.

Over the 1970s, repayment rates declined, averaging around 90%. A significant deterioration in credit discipline occurred in the late seventies as a result of the drought and the RDP I which introduced the GCU to medium and long-term loans for purchase of farm machinery and inputs. The RDP I credit program provided D4.75m (equivalent to $2.4 million) in credit for seasonal crop inputs, oxen for draft power, and, animal-powered implements. Credit problems in RDP I began when the project's Socio-Economic Survey and Monitoring Unit ignored the established loan disbursement procedures and disbursed directly to farmers, many of whom were not GCU members or who already had outstanding balances to GCU.[17] Furthermore, as a Commission of Enquiry later found, the GCU credit staff embezzled the RDP I funds. The ADP II also contained a large agricultural credit component for on-lending through the GCU. $2.7 million of farm inputs such as draft animals, animal drawn machinery, coos mills, seed and chemicals were to be channeled to GCU members, either by cash or by credit. The ADP II credit program has experienced the same low level of repayments as the RDP I program (see Table 1).

b. Reform of the GCU

Since 1988, in response to reports undertaken at the insistence of the donors as well as the need for GCDB to rationalize its relationship with the GCU, the GCU has instituted new credit control measures. Its costs have been reduced and the interest rates it charges members have been increased to market levels. The government has absorbed most of its debts as well. The GCU now obtains its crop purchase finance on commercial terms: in 1990/91 the GCU borrowed from the Standard Bank and repaid the loan in full and on time.

Table 1: RDP I and ADP II Loan Recoveries
(Recoveries as of March 1989)

Project	Loan Category	Status
RDP I	Short-term	D0.5m received on D1.4m due; 27% recovery
RDP I	Medium-term	D0.9m received on D3.9m due; 18% recovery
ADP II	Pre 87/88	D0.7m received on D1.4m due; 50% recovery
ADP II	87/88, 88/89	D2.0m received on D4.3m due; 46% recovery

Source: GCU, as reported in Demissie, et al. 1990:55.

An important financial effect of the GCU was its impact on the GCDB. GCDB's loan portfolio was exposed heavily to the GCU. In March 1988, the GCU accounted for 24.7% of the GCDB's loan portfolio or D53.3m in credit outstanding. Of that amount, D19m was for crop credit and GCDB's management judged that it was unlikely to be repaid. Repayment of the remaining D23.2m (overdraft account) and D11m (transport account) was doubtful as well. (In the event, GCU only paid a small portion of its crop credit outstanding in March 1988, and the government assumed the bulk of it in 1989 and 1990.) In addition to the D53.3m in credit outstanding in March 1988, the GCDB had previously lent the GCU an additional D32.6m which the government absorbed in the Managed Fund Agreement of 1987.[18] The GCDB's lending to the GCU played a large role in its insolvency.

c. Economic Effects of the GCU

The GCU's main impact on the economy has been felt in three main ways:

- diminished financial intermediation;
- transfers rather than loans; and
- pressure on the dalasi's value and higher inflation.

These three effects are, respectively, the financial effect, the welfare effect and the macroeconomic effect. Government's involvement in credit allocation led to the neglect of savings mobilization and the application of non-commercial criteria to the allocation of loans.[19]

The credit programs reviewed here often failed to reach their intended beneficiaries. Many of those reached received transfers rather than loans. The GCU based its lending on non-commercial criteria. Politically-connected borrowers benefitted disproportionately. The loan officers who took advantage of their positions suffered no sanctions, save for suspension in several cases. The unsustainable nature of these programs meant that borrowers, while benefitting from cheap credit for a while, were left without access to credit when the programs closed down. Agricultural producers, taxpayers, holders of dalasi assets, and donors bore the costs of these failed credit programs.

The price level and exchange rate effects originated from the expansion of credit to which the GCU and the GCDB contributed. The increase in the supply of credit in the context of a fixed exchange rate, interest rate ceilings, and a budget deficit undermined confidence in the Gambian financial market.

4. An Analysis of Institutional Rural Finance During the ERP

While providing services at prices that farmers cannot easily find elsewhere, the cooperatives have involved the same problems as many other government agricultural cooperatives across the continent. These include high expenses to the government, tardy input deliveries, sometimes slow payments to farmers, transport and storage bottlenecks, low and falling repayment, lax accounting, and theft.[20]

Farmers' relations with cooperatives are ambivalent. They feel they have grown reliant on the cooperatives and value the goods and services provided, but at the same time many mistrust these bodies and feel alienated from them. What some credit analysts in The Gambia have called a decline in "credit morality" of borrowers is a result of this distinction. To many farmers, the issue is not one of morality, since the cooperatives are an arm of the government and are likely to be represented by strangers. Farmers in The Gambia tend to feel much stronger "moral" obligations to real kith and kin than to these impersonal institutions, even though the cooperative loans have been subsidized.[21] When discussing loan repayments, farmers frequently commented that it causes great shame in their communities to be seen pursued by government authorities for repayments. They worry that such visits might, among other things, hurt their informal "credit rating" with other villagers.

In recent years, a problem for farmers in dealing with the cooperatives has been the GCU's jerking shifts in lending policies, problems attributable in part to changing requirements by funding agencies and other outside organizations, and to national political pressures. More recently the shifts have been forced by economic realities. Some years the cooperatives have issued cash for land

preparation or food without seednuts, other years seednuts but no cash; fertilizers and tools have also been lent in some years but not others.[22] This has made it difficult for farmers to factor cooperative inputs into their planning. Debts have been forgiven in some years, but not in others, so some farmers who have repaid their loans on time have later felt cheated. More consistently and predictability are needed.

a. The GCU As An Anomalous Unit

A central problem is that the cooperative societies are not based on any locally recognized social, political, or economic units. Their domains are smaller than the district (in 1988 there were some 86 societies in 35 districts, making an average of 2.5 per district) but larger than the village (there are some 1,300 villages in The Gambia, thus an average of 15 villages per cooperative society). Districts themselves are recent inventions dating from the colonial period; villages are the largest traditional social units effective now in The Gambia.[23] So the primary cooperative societies are a political anomaly.

It is clear from the findings presented herein and elsewhere[24] that the informal credit systems that work in The Gambia are based on pre-existing social relations. Most of the lending occurs at very local levels: within villages, and often between neighboring compounds within villages; or, where it occurred over distance, between close kin or long-term trading partners. An implication is that to succeed, the cooperatives should find ways of making farmers' repayments consonant with their obligations to relatives, neighbors, and friends. This means using smaller groups than the present primary societies with memberships much larger than average villages as the elementary units of collective responsibility.

The cooperatives have made moves toward giving villages more responsibility for repayment.[25] For the system to succeed, this is probably a step in the right direction. The village is a natural unit to choose, for several reasons. It is spatially compact, it is socially and economically intimate, and it has its own political hierarchy. It is ethnically integrated: even where its members are of mixed groups, these will usually be groups that can get along. Its members have countless involvements with and obligations toward each other. Not all relations within villages are friendly, of course, but there is no unit larger than the village with such solidarity.

The village need not be, however, the smallest unit of joint responsibility. Larger villages are sub-divided into wards, each usually organized around a core lineage group, and these too would seem a sensible choice in some ways.[26]

Administratively, dividing village or wards groups into separate men's and women's groups for responsibility toward the cooperatives

might be another possible measure, if an equitable system of allocation and recovery could be worked out. This would reflect the separation of men's and women's financial affairs that Gambian farmers tend to consider natural. The division might also add possibilities of female representation in the cooperatives committees, and allow a better accounting of the resources being allocated to men and women.

The cooperatives have also begun (in a preliminary way) to use of villages as units of collective responsibility for repayment. Both these moves are making the cooperative organization more consistent with customary modes of political and economic organization, and are steps in the right direction.

b. Links Between Cooperative and Informal Credit

The links between cooperative and "informal" credit systems are too many and complex for full treatment here, but these systems have become tightly intertwined. At local levels, the connections can be variously collaborative, charitable or exploitative. A basic point is that farmers frequently re-lend, sell, or give away resources they borrow from the cooperatives.

First they pass the resources to their families. Only a tiny fraction of cooperative members (probably about 1-2%) are women, so women's access to the loans is almost entirely indirect. Husbands re-lend to their wives. Usually, it seems, they try to pass on the exact interest charges levied by the cooperatives, but some add their own. In the villages visited in 1987, a few were found to charge their wives as much as 50% interest over six months on loans of seednuts they had received from the cooperatives, while paying the cooperatives 13% interest over the same period. Farmers re-lend cooperative seed-nuts to unrelated neighbors or "strange farmers" at higher rates: some admitted charging 100% over about six months. Though cooperative society members can and do profit by relending, they accept some risks in doing so, as they may have to repay or lose their borrowing rights when their own borrowers default. Relending spreads the resources of cooperatives to persons that the official lenders may consider uncreditworthy, though whether this is ultimately a service to them cannot be assessed here.

Sometimes several villagers group together to gain access to cooperative loans, helping one co-operative member among them to repay just enough of his outstanding debts to qualify for a loan in which they all might share. This strategy is sometimes used for procuring expensive implements from the cooperatives.

When inputs from cooperatives arrive late, as they have often done in the past, farmers none the less accept them, and they often sell or re-lend them. Farmers who have applied for loans may engage others to do their land preparation for them, on the promise of

paying them when their loans finally arrive.

In sum, the functioning of the cooperatives cannot be understood without taking into account a wide variety of unofficial activities connected to them. Farmers have woven the cooperatives into their own older and broader systems of borrowing and lending. The cooperatives have had a large role in fertilizer distribution and, to a large extent, groundnut seed distribution. Farmers have depended on the cooperatives for these things, but the cooperative system in turn depends on farmers' private arrangements among themselves.

5. Concluding Observations

The GCU's credit program over the period 1978 to 1988 confirms the well-known lesson that below-market rate credit delivered by a weak or politicized institution simply transfers resources to loan recipients leaving the costs to be borne by the whole society. While the impact of the new measures on the GCU's future as a financial institution cannot be judged, it is clear that it will only contribute to sustained development of the rural population in The Gambia if the generation of a financial surplus becomes its principal objective.

In addition to its large fiscal impact. subsidized credit provided by GCU generated distortions in important rural markets. Private traders were driven out of the groundnut sector resulting in less competition and lower quality service.[27] Marginal producers, without connections to easy credit, were at a disadvantage. The process of rehabilitating credit and output markets which these failed interventions have distorted is taking years.[28] The credit programs also distorted incentives within the government bureaucracy for they provided numerous opportunities for rent-seeking by civil servants and credit program operators.

Credit will never improve farmers' livelihoods by itself. While it helps them survive a boom-and-bust seasonal cycle, and to weather years of low harvests, it is as likely to addict and impoverish farmers in a vicious circle, as drinking seawater dehydrates a sailor, or to bond them to their lenders in ways they will eventually resent. Gambian farmers want to save as much as to borrow. A lesson for policy makers is that instead of placing all their attention on the delivery of credit, they might emphasize policies which facilitate savings and the mobilization of local resources. Much remains to be learned from farmers about how to combine credit with local savings for sounder and fairer financial systems, and about what kinds of finance they need in the first place.

A basic lesson of the impact of institutional credit on rural procedures is that sustainable institutions cannot be created.

Providing a conduit for credit and inputs is not a way the government can promote rural development. For a start, credit without savings mobilization is non-viable. Credit cannot be sustained if the institutions involved do not focus on generating a surplus. Furthermore, the financial services provided by the institutions have to supplement existing credit and savings relationships in the rural areas. When the institution contributes to financial instability, as GCU did, farmers cannot be expected to (and indeed will not) abandon established local financial relationships. In effect, if institutional finance is to play a sustainable supportive role in the development of rural Gambia it has to provide financial opportunities which within the local setting improve the liquidity, security, yield, and risk characteristics which farmers find attractive. Anything less will condemn institutional credit to a peripheral status, leaving it to farmers (as they have already done) to develop other mechanisms which link the formal and informal financial systems.

Endnotes:

1. Ramamurthy 1986; Clark 1987.

2. Shipton 1987; 1990; 1991.

3. The original field work was undertaken in 1987 (Shipton 1987). A review in 1992 indicated that most of the conclusions remain valid.

4. Though the term referred in the past to men's or women's age-grade organizations, and usually still does, it can refer more generically to various kinds of interest groups in a village.

5. By one recent estimate, of the 14,000 tons of undecorticated seednuts required annually in The Gambia, 50% are saved in village seed stores and 14% on the farms, while 36% are provided by the cooperatives (Clark 1987:32). These proportions are likely to vary, however, according to the size of the previous harvest.

6. Robertson 1987:228.

7. A PPMU survey found that in 1985-6, of 537 Gambian households (dabadas) surveyed, 421 procured fertilizer. Of these, 47% took it on loan from the co-operatives, 45% procured it with their own cash, and 8% received it through private lending channels (PPMU 1985).

8. A kondaneh box resembles the western style "piggy bank". Farmers engage carpenters to build the box which must be broken in order to be opened.

9. Technically, "illiquidity preference" does not refer to the characteristics of the asset. It refers to the self-imposed constraints which make it difficult for the asset-holder to gain access to his/her resources.

10. Johnson 1967; Meier 1983:Ch.2.

11. The Gambia Co-operative Central Banking and Marketing Union was re-organized in 1971 into the Gambia Co-operative Union Ltd., when its banking functions were transferred to the Gambia Commercial and Development Bank.

12. The Co-operative Thrift and Credit Societies (CTCS) were a specialized sub-system of the cooperatives up to 1988, when the World Bank forced its trimming for financial reasons. There were then around 80, serving some 3,700 members. About 85% of these were women, but the societies were managed largely by men. Most of their members lived in the cities and towns. Approximately, 50% of them were small-scale traders; others included gardeners, tie-dyers and other artisans, and salaried workers including dock workers.

The CTCS combined savings and credit functions; D207,500 total savings were recorded in 1986. Evidence from villages suggests that the CTCS are not used.

13. With inflation of 12% in 1987/88 this represented a real rate of interest of 12-14%. Based on groundnut prices, which fell by 17% during that year, the real rate of interest is 41-43%.

14. Clark 1987.

15. Demissie et al. 1989:52.

16. Clark 1987.

17. Clark 1987.

18. See chapter 15.

19. Savings mobilization provides the credit institution with a market-determined cost of funds. To lend efficiently, banks need some practical guide as to the cost of funds in order to select among competing borrowers. That guide is distorted when government simply allocates credit.

20. Ramamurthy 1986; Clark 1987.

21. In Africa this difference is usually most pronounced in societies with lineage-based kinship systems, such as Gambians have. See Shipton 1985.

22. Clark 1987:Table 2.

23. See Gamble 1955:1; Haswell 1975:28; Dunsmore et al. 1976:269. Some of the districts were based on and named after older political units, which precolonial travellers sometimes called 'kingdoms', but these units varied greatly in size and nature and no longer have official recognition.

24. Shipton 1990.

25. Co-operative society committee members are chosen as representatives of individual villages. In public announcements about loan arrears, the names of villages (but not individuals) are mentioned.

26. Dunsmore et al. 1976:269.

27. Jones 1986.

28. Five years have passed and the damage of the GCU's failed credit programs continues. Private sector investors display reluctance to re-enter the groundnut marketing trade. The greatest

damage may be in the area of "credit morality". The GCU's lax credit procedures created the impression that development projects provide agricultural inputs for free.

10

Budget Reform During the ERP

Paul E. McNamara

1. Introduction

Although the ERP emphasized changes in fiscal policy, government officials showed no enthusiasm for efforts to change the underlying budget process. Consequently, little has been achieved. That failure has left many chronic budgetary problems unaddressed. The story of the attempts at budget reform during the ERP illustrates the difficulty of achieving the level of organizational effort and policy maker support necessary to measurably improve the quality of the government's expenditure decisions.

This chapter reviews the attempts made throughout the ERP to promote budget reform. Section 2 discusses why budget reform was a key element in the ERP. Section 3 describes the budgeting system which the GOTG used in 1986 and its shortcomings. Section 4 discusses the budget reforms which the ministry of finance considered over the ERP period. Section 5 examines the difficulties experienced in implementing budget reforms. Section 6 has concluding comments.

2. Budget Reform and the ERP

Changes in budget policy were a high priority in the ERP. Actions to "reduce fiscal deficits, improve the efficiency of public administration and rationalize the external debt situation" were seen as immediate needs.[1] It recommended the curtailment and adjustment of expenditure, and measures designed to increase the productivity of public sector investment.

The public sector initiatives were to be broad-based. There would be an embargo on the creation of new posts and regradings from 1986 through 1989. A staff audit of all vacant and temporary posts was to identify redundant positions so that the necessary retrenchments could occur. A more comprehensive staff audit was to be undertaken. It would analyze whether each civil service position was necessary for the current level of services being provided and the level of expenditure for training and support needed for the efficient provision of those services. Renumeration levels were to examined against the criteria of whether they were sufficient to retain qualified individuals. The result of this study would be a five-year plan to streamline the civil service.

The ERP planned a shift in expenditure from wages to materials and supplies for the maintenance and rehabilitation of government assets. A study of the recurrent funding requirements, especially in the ministries of health, education and agriculture was to be undertaken. The ERP also called for the rationalization of the government's vehicle fleet, with an audit "to review the justification, allocation, and maintenance requirements of all Government vehicles." Other expenditure measures included the commercialization of the workshop of the Public Works Department

and the improvement of the efficiency of vehicle maintenance.

As Table 1 shows, the fiscal situation at the outset of the ERP also provided impetus to budget reform. With the exchange rate reform and the government's commitment to pay debt service on time, debt service charges rose sharply from D19.7 million in 1985/86 to D63.9m in 1986/87. Furthermore, the ERP required that transfers and subsidies to parastatals be explicitly included in the budget. This placed additional pressure on the fiscal resources available to fund recurrent expenditures. Despite the fact that most budget heads saw little increase in funding over fiscal years 1985/86 through 1987/88, the full funding of debt service and transfers meant that few increases in other areas could be financed. Indeed, given that inflation was 31% over those three years, the government could not sustain real levels of expenditure in most cases. With such pressure on the budget, one objective of budget reform would be to "stretch" the recurrent budget through improved efficiency in the government's operations.

Although the ERP called for improvements in the quality of public investment, the underlying process which had led to the inefficient spending plans and public deficits, was not dealt with directly. Reform of the budget process was not listed among the actions required under the ERP. Yet, as specific measures began to be implemented, e.g., the reduction in staff and the vehicle audit, it became clear that changes in the budget process were essential. Areas that required special attention were the introduction of more rational analysis of spending plans, improved communication, the better ranking of expenditure priorities, and the use of a longer time horizon in the budgeting exercise.

3. The Budget Process in 1986

Some members of the government and most donor officials felt that the budget process in The Gambia undermined the effect of public spending. The Gambia had maintained its line item budgeting system from colonial times. That system emphasized control and the matching of expenditures with budget categories rather than the analysis of activities or program outputs. Over time, the control orientation had allowed the budget to be used for influence-peddling and kick-backs. Officials responsible for approving payment vouchers regularly received a cut of the purchases they approved.[2] Favors could be extracted by delaying a voucher's approval. Higher up officials gained influence through the selection of vendors for government contracts and through the allocation of funds to the various spending ministries.

Donors also played an important role in the budgeting process at the outset of the ERP. As part of the Stand-By, the IMF required strict control over the overall level of government expenditures in order to reduce the fiscal deficit. The IMF also required that all

Table 1: GOTG Recurrent Expenditures, Fiscal Years 1985-1989
(Dalasi millions)

Budget Head	Fiscal Year 1985	1986	1987	1988	1989	Percent Change: 1985-89
President's Office	10.6	11.1	10.5	22.0	17.4	65
Legislature	0.5	0.5	0.4	0.6	0.6	22
Public Service	0.1	0.1	0.1	0.1	0.1	50
Audit	0.3	0.3	0.3	0.4	0.6	90
Ministries of:						
Defense	5.0	6.0	8.6	11.1	17.4	248
Interior	7.7	8.5	9.5	12.0	13.7	78
Infor. & Tourism	4.3	3.9	3.8	6.8	7.3	67
External Affairs	5.7	6.9	13.2	19.3	17.4	206
Justice	1.2	1.8	1.7	1.9	2.6	120
Finance & Trade	7.0	7.7	12.4	17.9	18.1	158
Local Govt & Lnds	3.7	3.9	4.6	5.0	6.0	63
Agriculture	11.2	10.7	9.4	13.3	11.0	-2
Water Resources[1]	3.6	4.1	3.7	4.8	5.6	55
Works[2]	12.5	11.2	10.2	15.0	13.8	11
Planning[3]	1.5	1.5	6.1	2.0	2.5	72
Education	23.4	24.2	24.8	28.4	35.1	50
Health	15.1	14.7	17.9	20.7	23.2	54
Pensions and Gratuities	5.0	6.5	9.0	8.0	7.6	51
Debt Service Charges	8.7	19.7	63.9	110.0	149.8	1626
Miscellaneous[4]	3.9	7.6	105.5	154.8	53.6	1265
Total:	130.9	150.8	315.4	453.9	403.1	208

Source: Estimates of Recurrent Revenue and Expenditure various issues.

[1] Min. of Water Resources, Fisheries, and Forestry
[2] Min. of Works and Communications
[3] Min. of Economic Planning and Industrial Development
[4] The large increase in miscellaneous expenditures from 1985 to 1987 and beyond resulted from the inclusion of "extraordinary" payments to clean-up past debts of the GPMB and the GCU. Also included in the miscellaneous figures are subsidies to the GPMB and local contributions to development projects.

debt service be paid in full and on time. These two requirements reduced the resources available for civil service salaries and programs related to health, education, public works and agriculture. The World Bank pressed for additional requirements in the context of its Structural Adjustment Loan. These included: the development of a three year rolling budget (a Public Expenditure Program) and a shift in spending away from salaries and toward supplies and the maintenance of equipment. While the IMF focused its attention on the overall level of spending, the World Bank became more involved in the allocation of spending between ministries and across sectors. USAID's African Economic Policy Reform Program (AEPRP) grant to The Gambia required the GOTG to make transfers to parastatals transparent in the budget.[3]

In The Gambia, two separate budgets are prepared: a development (capital) budget and a recurrent budget. In 1987, the ministry of finance was responsible for preparing the recurrent budget. The development budget was the responsibility of the ministry of planning (MEPID).[4] The recurrent budget is prepared as follows:

- January/February: MoF sends out budget circular containing deadline for budget submissions to ministries.
- February/March: ministries submit their personnel details and the MoF and the Personnel Management Office examine requests.
- March/April: ministries submit their recurrent budget estimates. Budget meetings are held between MoF and ministries to review the requests. MoF aggregates the submissions to estimate the overall budget.
- May: IMF and World Bank come to Banjul and, in the course of adjustment program negotiations, budget spending limits are set. MoF makes adjustments to budget submissions.
- June: budget is presented to cabinet and then parliament. Fiscal year begins July 1.

As a means of highlighting specific problems in the budget process, a consultant interviewed senior officials in the ministries of finance, planning, agriculture, education and health.[5] Officials raised two types of problems in the interviews: those requiring fundamental changes to the budget system, and those where improved performance (better communication for instance) within the current system would resolve the problem. The issues that could be solved without basic changes in the budget system included:

- late and inaccurate submission of budget forms;
- insufficient consultation with the operating ministries and the non-involvement of some key operating and administrative personnel;
- unclear instructions and insufficient consultation with operating ministries;
- lack of penalties or rewards to spur performance;

- finance ministry decisions about detailed budget items which caused imbalances within an activity and hampered its implementation;
- late reporting of expenditures which interfered with effective budgeting and the allocation of funds;
- inadequate knowledge and control over the implementation plans and progress of foreign-aided development projects made it difficult to prepare accurate development estimates;
- ministry personnel responsible for implementing programs and some senior administrative officers were not actively involved in the formulation and review of budget proposals; and
- the finance division of the ministry of finance, with three full-time officers, was understaffed to manage the recurrent estimates process effectively.

Other problems with the budget system required fundamental changes. The failure to analyze activities or to pose trade-offs between alternative spending options were major weaknesses. Budget officials did not pay much attention to the assessment of priorities among activities. Indeed, the guidance for preparing the budget estimates did not call for a justification of priorities.[6] The limited staff devoted most of their time preparing the personnel rolls and related details. The goals, achievements, and efficiency of those personnel were generally ignored.

Preparing budget estimates for a longer time horizon would have entailed major changes in the budget process. The projection of the budget of The Gambia for one year into the future did not capture important linkages between development projects and future recurrent spending required for maintenance and operation. By failing to analyze the future cost of the proposed activities to which the government was committed, the government generally assumed obligations for recurrent and local contributions to development projects that it did not have the capacity to meet (see chapter 13).

4. Proposed Reforms

The consultant recommended to the permanent secretary that a task force be assembled to work on pressing budget issues. Two topics deserved immediate attention: the determination of spending priorities; and options for developing a rolling three year budget. The task force would consist of government officers involved in program management, administration, and finance in the operating ministries as well as budget and treasury officials. The officials were to be convened after the budget session so that discussion would center on the overall process and not on specific cases of budgetary allocations. No action was taken by the ministry on this proposal.

A second opportunity for reform of the budget system occurred in early 1987. The consultant met with senior finance ministry officials and proposed incremental changes in the budget process for the coming year.[7] Changes included improvements in the guidance ministries were to receive regarding budget submissions and changes in the budget hearing process. The ministry of finance was to request that ministries submit two alternative budget proposals in addition to one that was to match the revised estimates for the current year. The alternative budgets were to be 10% less and 10% more than the current year. Ministries were only to complete the alternative budgets to the subhead level. These alternatives were to be used to elicit the spending priorities of each ministry and to allow each ministry the responsibility for making budget trade-offs.

The budget submissions were to include a statement of purpose for each subhead and a statement describing the targets or accomplishment the ministry expected to achieve over the fiscal year. The ministry of finance was to communicate these changes to the ministries both through a memo and through a seminar to be held before the submissions were due. Changes in the budget hearings were also suggested. They would focus on organizational and operational issues that affected budget levels. Issues having an important budgetary impact that might be raised to higher decision-making levels were to be identified. Analysis of alternative decisions would use a microcomputer located in the hearing room. Like the reforms proposed earlier, these suggestions were not implemented.[8]

Finally, in an effort that had some impact, the EFPA project provided microcomputers for the preparation and analysis of the budget. The project also supported the development of software program designed to facilitate budget revisions and analysis. Called the MinFin budget system and based on a Lotus 1-2-3 spreadsheet, this program allowed the examination of changes in budget allocations and their effects on the bottom-line. Project staff assisted with the training of finance division personnel in the use of microcomputers, Lotus 1-2-3 and the budget system. Several ministry personnel were also sent for training at the HIID summer workshop on budgeting. A parallel exercise was undertaken for the development budget.

5. Why Did Budget Reform Fail?

With the exception of the introduction of the MinFin computer program no significant changes in the budget process emerged from these proposals. Much effort has been devoted to the consideration of improvements in the budget system and the training of finance officials, yet the government's budget process is still characterized by almost a complete lack of analysis. Why has change been so difficult?

There are several explanations. Budget reform has not received the necessary support from senior ministry officials, particularly the permanent secretary. A more open and rational budget process would likely have reduced the scope for discretion on the part of ministry of finance officials. On one level, budget reform threatened the system of kickbacks on local purchase order (LPO) and bribes associated with payment vouchers. At the policy level, a more rational budget process would undercut the discretion of the cabinet to engage in extra-budgetary expenditure. Cabinet frequently takes expenditure enhancing and revenue-reducing measures at any point in the budget cycle, e.g., to provide for unbudgeted expenses of official entourages or to waive duties on an investment project. The minister of finance would have faced serious opposition if he were to attempt to limit his colleagues in this way.

For the ministry of planning, an analytic approach to budgeting would have sharply reduced the number of development projects in order to bring development spending into line with available recurrent cost funding. Budgeting in The Gambia never formally linked the development budget with the recurrent budget. The ministry of planning and the ministry of finance tended to respect each other's turf by not raising issues which crossed their separate agendas. For instance, the ministry of finance could have asked whether the funding necessary to staff and equip the planned new high school was likely to be available in the future. Likewise, was the petrol budgeted in the recurrent budget for agricultural extension being used for extension visits or shuttling Banjul-based agriculture ministry officials and their families around town? The ministry of finance had already raised the ire of other ministries by centralizing control of expenditures to meet the deficit targets agreed with the IMF. Even though officials in line ministries complained about aspects of the on-going budget process, a reformed budget process focused on program outputs would have involved closer scrutiny of the activities of line ministries. The permanent secretary of the ministry of finance was reluctant to antagonize other ministries in this way.

In addition to the lack of enthusiasm for budget reform within the government, none of the donors initially pushed for substantive changes. The World Bank called for the development of a public expenditure program linking the development budget with the recurrent budget as part of its conditions for its Structural Adjustment Loan. Other donors, however, avoided the issue of budget reform.[9] In particular, the IMF focused on the adherence of expenditure to overall targets designed to reduce the deficit. One result of the IMF's strict focus on aggregate spending totals was the erosion of budget discipline within the fiscal year. "Emergencies" were dealt with by delaying payments. The result was that line ministries with funds budgeted to buy petrol or other operating materials could not purchase the inputs needed to support

their programs. None of the other donors promoted budget reform. They did, however, continue to fund development projects despite the widespread understanding that the government would make virtually no contribution to their future operating costs.

There was little resistance to th implementation of MinFin computer program primarily because it d not change any official's discretion in the budgetary process. The MinFin software simply put the existing budget on a personal computer greatly speeding-up budget preparation. Along with facilitating budget analysis, the MinFin system reduced the drudgery in budget preparation and helped produce a draft budget in less time than previously. The ability to modify the proposed budget negotiations with donors on fiscal targets quickly proved beneficial. However, the MinFin program did nothing to introduce more rational analysis into the budget process. Nor was it used for the monitoring of expenditure, a task for which it was ideally suited.

6. Concluding Observations

Administrative reform measures, such as budget reform, that are complex, produce benefits after a long gestation period and raise conflicts within the bureaucracy are likely to face difficulties in generating the necessary support for their successful implementation. In their analysis of this type of organizational reform, Grindle and Thomas hypothesize:

> that when the response to a reform takes place in the bureaucratic arena, the political stakes for the leadership and for the regime are relatively low. The real issues are whether government capacity exists to implement the reform and whether there is support for the reform that will cause the bureaucracy to comply with the intention of the decision.[10]

In The Gambia, training and technical assistance helped alleviate the ministry's capacity constraints but top government officials did not demand the type of information and policy choices that a reformed budget system would generate. Instead, most government officials preferred to continue budgeting and spending in a manner which avoided explicit analysis of government programs and expenditures.

The attempts at budget reform during the ERP made no progress toward the objective of improving the efficiency of public expenditure. The inability of the ministry of finance to introduce analytic measures and improve financial management does not augur well for other administrative reforms still called for in The Gambia. Indeed, budgetary control diminished as the government moved further away from the crisis atmosphere of 1985 - supplementary appropriations increased from D1.7 million in 1986/87 to D13.6 million in 1987/88 and to D38.8 million dalasis in

1988/89. A recent IMF team noted:

> The expenditure controls that have been introduced [during the ERP] rely heavily on centralized control over voucher processing, tendering and the payments process. These have been effective in maintaining aggregate control over cash outlays and meeting quarterly credit targets, but the operation of the system has greatly reduced the decision-making authority of the spending ministries, has allowed resources to shift between budget heads during budget implementation, has made suppliers unwilling to supply to government on credit, and has impeded the quality of service in some areas.[11]

The control necessary to meet macroeconomic targets was exercised in a manner which undercut the budgeting and financial planning process. Tight controls were needed because strong ministries and agencies (for example, the president's office) were able to press their contingency funding requests (supplementary appropriations) at the expense of budgeted spending. Until the SAPs are controlled, efforts to strengthen the budget process will be thwarted. Indeed, until SAP's are controlled, budgeting will be meaningless.

Further weakening of the budgetary process as the ERP proceeded is evident in the change in expenditure from the pre-ERP base. The greatest increases in spending (in percentage terms) were realized by the ministry of defense and the ministry of external affairs while ministries such as health, works and education fared worse. Expenditure allocation in the last three did not even keep pace with inflation. While the stated budgetary goals were the provision of materials and supplies to ensure that health services were delivered, roads maintained and school books provided, the largest increases in funding went to the army and the overseas missions.

During an economic crisis, improvements in the budgetary system are of secondary importance. Yet, if public spending is intended to generate future economic growth then changes in the budget process are required at some stage. That stage is now long overdue in The Gambia.

To sum up, the attempts at budget reform in The Gambia were a failure. The substantive reforms which were recommended did not gain the necessary support and were not acted upon. Although the budget has been computerized, making its preparation easier, no perceptible improvement in budget analysis occurred. Government decision makers would not support the proposed reforms because they jeopardized their scope for discretion in determining the level of allocation of public expenditure.

Endnotes:

1. GOTG 1985.

2. Information provided by merchants in Banjul and other government officials.

3. That was also a requirement of the performance contracts between the government and the public enterprises.

4. In a reorganization in September 1990, economic planning was absorbed in the ministry of finance and economic.

5. Gordon 1986.

6. To deal with this problem an alternative approach such as program based budgeting would have to be introduced.

7. Gordon 1987.

8. A seminar was held on budgeting for those involved in the preparation of each ministry's submission. Initially, the permanent secretary in the MoF attempted to impose more structure on the hearing process. The seminar did nothing substantive to change budget behavior; the hearing process quickly lost its structure.

9. The World Bank's 1985 country memorandum called for such a public expenditure program (PEP) and the 1986 SAL included a condition concerning the creation of the PEP. That condition was not met during the ERP. The lack of progress on the PEP led to delays in disbursing the World Bank's SAL II. In the end, the PEP was developed by a team of World Bank-financed consultants after the ministry of finance and other concerned ministries failed to draft a PEP (see chapter 19).

10. Grindle and Thomas 1991:177.

11. Allan, Woolley, and Rumbaugh 1991.

11

Tax Reform in The Gambia

Clive S. Gray and Malcolm F. McPherson

1. Introduction

The structure of The Gambia's tax system, and even the basic rates of most taxes, showed little change from the colonial period well into the 1980s. A succession of IMF reports highlighted deficiencies such as excessive reliance on trade taxes, confiscatory rates of personal income tax, and rampant evasion at many levels.[1] The first concerted response to these reports came in 1983 with Minister Sisay's establishment of a staff committee to review personal and company taxes.

It took five years for the sporadic deliberations of this committee to result in major amendments of the income tax law. Meanwhile separate reviews of taxes collected outside the ministry of finance (MoF), investment incentives, customs fraud, and a proposed national sales tax were undertaken. Reforms pursuant to these reviews have by now brought about significant changes in tax structure and administration.

This chapter examines the process of tax reform in The Gambia, indicating both accomplishments and areas in which progress has been slow. Section 2 examines the imperatives for tax reform. Section 3 focuses on the income tax, while Section 4 reviews indirect taxation. The concluding section 5 highlights lessons from The Gambia's experience.

2. Imperatives for Tax Reform in The Gambia

Tax reform is not something that ministers of finance relish. Typically, major reforms are undertaken only under extreme fiscal pressure. This was the case in The Gambia. A budget deficit that averaged 2.7% of GDP in the two fiscal years ending in mid-1976 rose to 7.5% in FY'77 and averaged 9.5% in the fiscal years 1978-79.[2] The overspending and undercollection of revenue underlying the deficits were largely to blame for the disappearance of The Gambia's foreign exchange reserves by the end of 1979 (see chapter 2).

Beginning with the capital gains tax in 1978, several new taxes (and variations of existing taxes) had been introduced in an effort to reduce the deficit. However the revenue response was small - in 1982/83 the new taxes were producing only 1.2% of recurrent revenue.[3] An additional complication was the abortive coup attempt in July 1981, resulting in major destruction of property and compressing the income and trade tax bases.

Several factors persuaded Minister Sisay to take a broader look at the tax system. The persistent budget deficit is cited above. With the general decline in prices and output of groundnuts, the surpluses which the Gambia Produce Marketing Board (GPMB) had regularly turned over to the treasury or allocated to extra-budget

expenditures had disappeared,[4] forcing a scramble for new sources.

Second, even at its peak before the coup, the personal income tax was producing less than 10% of recurrent revenue. The income tax for low-income employees was not cost-effective. The progression of tax rates, culminating in a marginal rate of 75% at taxable income of D50,000 (equivalent to $19,000 at the average official exchange rate during 1983), was an open invitation to evasion in the upper income groups.

Third, as the other side of the coin vis-à-vis the desirability of increasing direct tax revenue, Sisay accepted that heavy dependence on revenue from taxes on international trade - 70% in 1982/83 - left The Gambia highly vulnerable in the event of establishment of a customs union under the protocols of the Senegambia Confederation in effect at the time.

Finally, customs fraud had become a major drain on government revenue as well as an open scandal.

Table 1 gives data on the structure of the Gambian tax system in 1965/66, 1975/76, 1980/81, 1985/86, and 1988/89, showing its dependence on international trade taxes as well as the mounting imbalance between revenue and expenditure.

MoF staff work on tax reform proceeded on a number of levels:

- As noted above, a staff committee was established to examine the income tax. A consultant drafted its report in 1985; a revised version was finally submitted to cabinet in December 1987 and became the basis for the 1988 law.
- Another consultant undertook a review of several minor taxes and charges collected outside the MoF with a view to rationalizing tax collection and revenue monitoring. The review revealed that the tax 'system' lacked coherence. Follow-up work on this issue led to recommendations for establishment of a Central Revenue Department and a Statistics and Special Studies Unit within the ministry to analyze and monitor all aspects of taxation in The Gambia.[5]
- Special studies were undertaken on the introduction of a VAT or general sales tax.[6]
- There were extensive investigations of customs fraud in 1986, 1988, and 1989.
- With a view to limiting the revenue loss from tax holidays, the Development Act (1973) was revised.
- Finally, numerous issues arose in the administration of the transit trade, the handling of duty waivers, and the taxes collected by public enterprises on behalf of government.

Table 1: The Gambia's Tax System, Selected Years.

	1965/66	1975/76	1980/81	1985/86	1988/89
Direct Taxes	.4	4.8	17.4	32.1	57.2
Company	.2	2.4	8.9	15.0	31.5
Personal Income	.2	1.9	7.7	11.6	18.2
Other	--	.4	.9	5.5	6.0
International Trade	8.7	31.6	48.4	147.3	215.6
Import Duties	8.0	27.1	47.6	138.1	214.0
Groundnut	.7	4.6	.1	8.1	--
Domestic Taxes	--	1.0	3.7	13.1	125.0
Excise Duties	--	--	1.0	6.2	1.2
Sales Tax	--	--	--	--	113.3
Other	.1	--	.5	1.6	.6
Total Tax Revenue	9.2	37.4	70.1	194.1	398.4
Non-tax Revenue	4.4	8.6	9.9	21.6	41.7
Grants	7.2	1.9	24.3	59.1	135.6
Total Revenue*	20.8	48.0	104.2	274.9	575.7
% of GDP					
(inc. grants)	21.0%	17.6%	25.5%	32.0%	38.7%
(exc. grants)	13.6%	16.9%	19.5%	25.1%	29.5%
Budget Deficit (exc. grants)#	4.9%	3.4%	19.2%	10.4%	6.8%
GDP	100.3	272.9	409.4	859.3	1489.5
GDP Deflator	46.0	74.2	100.0	174.3	259.5

Note: * Totals may not correspond because of rounding.
1985/86 excludes an increase in arrears of 3% of GDP. 1988/89 includes a reduction in government arrears of 1.7% of GDP.

Source: Estimates of Recurrent Revenue and Expenditures... various issues.

3. Reform of Direct Taxes

Under the Income Tax Act (1966), individuals were assessed according to Schedule I or IV, whichever resulted in the greater liability. Table 2 displays the two schedules along with dollar equivalents for successive income band thresholds at average official exchange rates prevailing during 1980 and 1985, respectively.

Table 2: Brackets and income bands of personal income tax
Schedules I and IV

SCHEDULE I
Income Bands

Marginal tax rates	Dalasis	$ equiv. of threshold at exch. rate of: 1980 rate= D1.719	1985 rate= D3.857
2.5%	<1000	0	0
3.3%	1000 to 2000	$582	$259
5.0%	2000 to 3000	$1,163	$519
6.5%	3000 to 4000	$1,745	$778
12.5%	4000 to 5000	$2,326	$1,037
17.5%	5000 to 6000	$2,908	$1,296
22.5%	6000 to 8500	$3,490	$1,556
27.5%	8500 to 11000	$4,944	$2,204
37.5%	11000 to 12500	$6,398	$2,852
50.0%	12500 to 40000	$7,270	$3,241
62.5%	40000 to 50000	$23,264	$10,372
75.0%	>50000	>$29,080	>$12,965

SCHEDULE IV
Income Bands

Tax	Dalasis	$ equiv. of threshold at exch. rate of: 1980 rate= D1.719	1985 rate= D3.857
D 8.75	1000 to 1250	$582	$324
D12.50	1251 to 1500	$728	$389
D18.75	1501 to 1750	$873	$454
D18.75 + 1.67%*	>1751		

Schedule IV contributed just over 1% of total personal income tax collections. With a high degree of progressivity built into Schedule I, an underlying inflation rate on the order of 8 to 10% during the 1970s, and a major expansion of urban-based, government-controlled economic activity, personal income tax should have been an elastic source of revenue.

This was in fact the case during the first 15 years of independence, when personal income tax receipts grew 14 times faster than GDP. By contrast, since 1980/81 they have risen more slowly than GDP. Indeed, reflecting the aftermath of the attempted coup, receipts declined in both 1981/82 and 1982/83.

The drop in the elasticity of personal income tax is illustrated by data from seven years before and after 1980/81. From 1973/74 to 1980/81, the elasticity was 4.9; between 1980/81 and 1987/88 it was 0.4. Some of the change can be explained by special dispensations granted by the president (under section 3.2 of the Income Tax Act) in the aftermath of the coup attempt. Most of it, though, is attributable to an increase in tax evasion.

In the remainder of this section we shall highlight the work of the staff committee established in 1983 which culminated in the passage of the Income Tax (Amendment) Act (1988). Other aspects of tax reform such as the review of taxes collected outside the MoF, the reform of the indirect tax system, the passage of the revised development act, and the effort to computerize the tax system are dealt with in subsequent sections.

In May 1983 the minister reported to cabinet that this committee would complete its task by October. That deadline and several others were missed. With implementation of the ERP other issues became more pressing. Moreover, the committee members were never fully agreed on some questions.

The main issues confronting the committee were:

i. Personal Income Tax
   -- personal and spouse allowances
   -- child and education allowances
   -- Schedule I rates
   -- Schedule IV rates
   -- National Development Levy
   -- taxation of perquisites in kind
   -- introduction of comprehensive withholding
   -- enforcement and penalties

ii. Company Income Tax
   -- capital allowances
   -- capital gains taxation
   -- turnover or minimum tax
   -- system for accelerated collection

The personal tax system was widely seen as inequitable, inefficient and ineffective: inequitable, both because earners of very low incomes were subject to tax and because the rates were so steeply progressive as to become confiscatory already for upper-middle-class taxpayers; inefficient, because skilled manpower was being diverted from the production of goods and services to devising ways to avoid (and evade) the tax; and ineffective, because collections were substantially below what was owed.

Schedule IV. At the low end of the scale the committee noted that 1980 assessments of 4,400 Schedule IV taxpayers, comprising 63% of all those assessed under either Schedule I or IV, amounted to only D26.6 per person or 1.2% of their declared income and around 2% of total personal income tax collected in that year.[7] Estimated from a random sample, assessments through mid-September 1985 of 2,300 self-employed Schedule IV taxpayers totalled D68,000 or D29.6 per taxpayer; as of the same date these individuals owed <u>seven times as much in arrears</u> from previous years.[8]

The Income Tax Division (ITD) was preparing - manually - and mailing out around 3,000 assessments per year, with virtually no follow-up. Even had the legal authorities been willing to pursue defaulters - see below - it would not have been cost-effective to go after those defaulting under Schedule IV. Finding that continued administration of the schedule consumed inordinate administrative resources while breeding derision regarding the division's efforts, the committee recommended that the schedule be abolished outright.

Schedule I - 1985 recommendations. Turning to the higher-income schedule, the committee saw, firstly, that arguments analogous to those against Schedule IV could be made for the first four brackets, with rates ranging from 2.5% to 6.25% and income bands capped by D4,000, equivalent to $2,300 at the average exchange rate during 1980 and only $1,000 at the 1985 average rate. Based on 1980 tax year data, the 52% of Schedule I taxpayers with incomes below D5000 owed only 3% of personal income tax.[9] Agreement was soon reached on the desirability of raising the zero bracket and eliminating the lowest rates.

A second route to administrative simplification favored by the committee from the outset was a reduction in the number of brackets and income bands under Schedule I, which numbered 12 in the 1966 Act. This was also considered desirable to improve horizontal equity by providing similar treatment to broad groups of income earners.

The same 1980 data showed that 85% of tax due under the schedule was assessed against the 13% of Schedule I taxpayers - 331 individuals - falling within the three highest marginal tax brackets, viz. 50%, 62.5% and 75%. In other words, the bulk of personal tax revenue was being collected from persons subject to confiscatory marginal tax rates. As shown in the table above, the

50% bracket started at chargeable income of D12,500, equivalent to $7,300 in 1980 and only $3,200 in 1985.

The same taxpayers declared 57% of total chargeable income under Schedule I. The committee did not dispute the principle of progressivity, that taxpayers accounting for more than half of chargeable income should pay an even higher proportion of personal tax. But they noted that the bulk of the 85% of assessments originated from salaries of a small set of expatriate and Gambian employees as declared by foreign and multinational employers whose traditions and interests would lead them to display relative transparency in their dealings with the government.[10]

As the other side of the coin, without attempting to quantify undeclared income the committee members noted that the majority of taxpayers with true incomes exceeding D11,000, the threshold of the 37.5% bracket (and equivalent to $6,400/$2,850 at the 1980/1985 exchange rates), were doubtless so repelled by the 37.5% to 75% rates as to make substantial efforts to hide marginal income taxable at those rates. In order to broaden the tax base it was considered necessary, even if perhaps not sufficient, to revamp the rate structure.

One aspect of broadening the tax base was to induce taxpayers to declare sources of income that had traditionally been poorly documented. One example was rental of premises. A cursory review of tax returns indicated that only a handful of known Banjul landlords were declaring rental income.[11]

The committee also had to take into account that the political commitment which government had shown in implementing strong measures in connection with the ERP had not yet manifested itself with regard to prosecuting tax evaders. The Commissioner of Income Tax showed the committee a complaint he had forwarded to the Attorney General as a test case of blatant personal tax evasion, the upshot being that no prosecution was forthcoming.

Indeed no Gambian court in recent memory had handed down a judgement against a tax offender. At most, a few individuals pursued by the ITD had chosen to pay, normally less than their true liability, rather than face continuing administrative harassment. Accordingly the Commissioner was skeptical that adopting stiffer penalties in an amended law, including "seizure and sale" powers, would broaden the tax base and improve compliance.

The committee debated at length how far the tax base would expand voluntary compliance in response to rate reduction. The Commissioner expressed concern about revenue loss from the few captive high income earners. The weight of this consideration led the committee to agree initially, in November 1985, on a rate structure that (i) reduced the top marginal rate only from 75% to 65%, and (ii) would have left the overall burden for most Schedule

I taxpayers, when account is taken of inflation, greater than it had been when the existing structure was determined in 1956!

The committee's 1987 report. As the committee continued its deliberations over the next two years, the weaknesses in the income tax system became more and more obvious. The view gained ground that, since personal income tax accounted for less than 10% of recurrent revenue, there was relatively little to be lost in experimenting to see how substantial rate reductions would affect the tax base.

The report which the committee finally submitted to Minister Sisay, and whose provisions were forwarded to cabinet in December 1987, the majority being adopted by Parliament in May 1988, recommended the following:

1. Introduction of a zero tax band up to D5000.
2. Elimination of Schedule IV.
3. Incorporation of the National Development Levy into the Income Tax.
4. Elimination of all personal allowances for education, wives and children, in effect replacing them with the zero tax band.
5. Reduction of the number of brackets from twelve to five, comprising 10, 15, 20, 25, and 35%.
6. Inclusion of income-in-kind, such as the value of cars, houses, and servants, in taxable income.
7. Introduction of a pay-as-you-earn (PAYE) scheme for all individual taxpayers.
8. Strengthening the powers of the Commissioner of Income Tax to improve compliance.

Comments on each of these provisions follow:

1-2. The D5000 zero tax bracket and elimination of Schedule IV removed over half the taxpayers from the rolls, simplifying administration and freeing up resources to improve compliance, with minimal foregone revenue.

3. The National Development Levy (NDL) was introduced as a temporary measure to support the first five year plan - taxpayers were told they were contributing directly to the development effort. In practice, the revenue was consolidated with other tax receipts and no direct link was ever established between NDL collections and development expenditure. Had the Levy in fact been temporary as originally intended it should either have been rescinded or incorporated into the income tax.[12]

4. The elimination of all personal and family deductions and their replacement with a minimum threshold of D5000 for each taxpayer was designed to serve two purposes: (i) eliminate the

incentive for high-income earners to exaggerate deductions, and (ii) eliminate the administrative burden of verifying each taxpayer's deductions.

5. Following is the new tax schedule, again indicating dollar equivalents for chargeable income thresholds (at the average exchange rates for 1988 and June 1992):

Table 3: Brackets and income bands under 1988 amendment

	Gross income bands		
		$ equiv. of threshold at exch.rate of:	
Marginal tax rates	Dalasis	1988 rate = D6.709	6/92 rate = D8.790
0%	<5000	0	0
10%	5000 to 15000	$745	$569
15%	15000 to 25000	$2,236	$1,706
20%	25000 to 35000	$3,726	$2,844
25%	35000 to 45000	$5,217	$3,982
35%	>45000	$6,707	$5,119

While the new schedule represents a sharp reduction in upper bracket rates, it remains progressive. At the same time it has increased the liability of some lower-bracket taxpayers by applying a marginal rate of 10% to income above D5000, now calculated without personal or family deductions. For example, a taxpayer with gross income of D8000 and former deductions of D3000 - close to the average proportion in that bracket[13] - used to pay D298 on chargeable income of D5000; now he/she pays 10%*(D8000-5000) = 0.1*D3000 = D300. The larger his/her deductions before, the greater the relative increase in tax liability.

Applying Lotus spreadsheets to random samples of 1985 tax assessments of (i) non-government employees and (ii) traders and other self-employed persons, the consultant working with the tax reform committee had earlier estimated the impact of the new schedule on the liability of taxpayers other than government employees. His findings are shown in Table 4. On the basis of their 1985 income data, nearly three-fourths of these taxpayers would have had reduced liability. The 27% facing increased liability would have seen their assessments rise by an average of only D23, or 5% of their actual 1985 assessments.

Table 4: Impact of 1988 Personal Income Tax Schedule on Samples of 1985 Taxpayers

Percentage of taxpayers with:	(A) Non-gov't employees	(B) Traders & other self-employed	(C) (A)+(B)
1. Reduced liability	93%	64%	73%
2. Increased liability	7%	36%	27%
Avg. increase for group 2	D130	NA	D23
Avg. % increase for group 2	35%	NA	5%

6. The inclusion of income-in-kind was intended to eliminate a major loophole in the law. Fifty percent of the value of expense accounts is counted as taxable income. Items such as electricity and water, servants (maids, gardeners, and guards) and transport allowances are now included on a cost basis. Housing is valued at 25% of the base salary level and cars at 10%.[14] Where these amounts exceed the cost of providing the service, the employer has the option of increasing the employee's salary to compensate for actual cost.

Finally, the law requires all lease agreements to be registered with the Commissioner of Income Tax. Leases contracted in foreign exchange are valued at the official dalasi exchange rate applicable during the week the lease was signed.

7. The pay-as-you-earn (PAYE) system of tax collection used to cover only civil servants, parastatal employees, and some large private enterprises. Other individual taxpayers were taxed on their assessed income for the previous year. Now, PAYE applies to all taxpayers. To discourage underdeduction of tax due, an interest penalty is assessed at two percentage points above the prevailing Bank Rate wherever the additional tax assessment exceeds 20% of the preceding year's deductions.

8. A new "seizure and sale" procedure empowers the Commissioner to appoint a government agent to seize a defaulting taxpayer's movable or immovable property and offer it for public sale to recover the amount of tax and penalties due. Moreover, tax clearance certificates are required before taxpayers are allowed to clear goods through Customs, license private and commercial vehicles, obtain building permits, or register a property sale.

Impact on revenue. Estimates showed that mechanical application to 1985 income data of a rate schedule similar to that contained

in (5) would have cut 1985 personal income tax assessments - not taking into account any change in the NDL - by around 25%. Two years later the Commissioner of Income Tax estimated that implementation of the foregoing package would cut revenue by D4 million in the first year (1988) - or D2.9 million not counting the NDL - and D2 million the following year. Considering that 1986/87 and 1987/88 personal income tax collections averaged D14.8 million, the two estimates were not far off: 25% of D14.8m. is D3.7m.

In the event, collections rose steadily during the three years following enactment of the new law, from D14.1 million in 1987/88 to D21.2 million in 1988/89, D26.0 million in 1989/90 and D29.3 million in 1990/91. The Commissioner's ex post rationalization to a reorganized tax reform committee in late 1991 was revealing. He made the following points:

- The ITD felt initially that government's drastic lowering of the rate schedule pushed it into a corner. It reacted by increasing collection targets and taking a 'stricter' approach toward known tax evaders, i.e. raising estimates of undeclared income and bringing more people into the net. In the Commissioner's own words, the division "changed its way of working".
- The striking outcome of this, again in the Commissioner's words, is that "I now get peace - there are many fewer complaints". The dual implication is that taxpayers are less resentful of the new (lower) rates, and more respectful of the division's administration of the law.
- The net continues to widen, and the positive revenue effect will become even more important.

4. Reform of Indirect Taxes

Reform of indirect taxes involved a number of separate activities. Three are examined here: the rationalization of revenue collection outside the MoF; the introduction of general sales tax; and changes in the tax incentives used to promote development.

a. Revenues Collected Outside the Ministry of Finance

By the early 1980s, The Gambia's system of taxes, charges and fees consisted of a patchwork of revenue items which had proliferated with no clear direction and purpose. New taxes had been added as the government searched for ways of covering its deficit. Whether the system of taxation resulted in a coherent, efficient, equitable, and effective way of raising revenue was not given much thought. It was certainly not analyzed in any detail because the staff within the MoF lacked the necessary capacity to determine how and whether the structure of taxes and

charges promoted the government's fiscal objectives.

There was no single agency with the responsibility for monitoring the collection of the revenue items so it was difficult to determine their economic impact. Furthermore, many of the collection agencies involved tended to treat revenue generation as a peripheral activity. Indeed, some agencies, such as the ministry of tourism, were in the anomalous position of trying to promote the activities which they were required to tax.

In order to better understand the situation, the minister of finance requested technical assistance to examine the various taxes collected outside the MoF and their performance.[15] The subsequent review considered all of the revenue items collected in 21 separate ministries and departments.

The report to the minister recommended some fundamental changes in revenue collection arrangements. It suggested that a central revenue department (CRD) consisting of the existing income tax department, and two new units - an internal revenue division, and a statistics and special studies unit - be created. The CRD would take responsibility for all revenue collected by all departments and ministries outside the MoF. The Commissioner of Income Tax was to be the director of the CRD.

Shifting oversight for revenue to the CRD did not necessarily mean shifting collection as well. Other agencies were often better placed to undertake that task. For instance, the police were in the best position to collect motor vehicle license fees and the road tax. The collection of some other taxes, however, needed to be reassigned. The airport departure tax were transferred to the customs administration which was well-represented at the airport. And, the collection of the hotel bed-night tax was shifted from the ministry of tourism (which preferred not to have to collect the tax in the first place) to the internal revenue division.

The Statistics and Special Studies Unit (SSSU) within the CRD would, as a first step, monitor tax performance and assess the impact of particular taxes on specific activities, groups, or industries. The idea was to begin with relatively simple analyses of tax buoyancies, tax elasticities, and tax incidence as a means of developing Gambian capacity to undertake more detailed studies of the tax system. As experience accumulated, the staff of the SSSU could turn their attention to issues related to compliance costs and the equity, effectiveness, and efficiency.[16]

The minister endorsed the report, cabinet approved, legislation was drafted, and the Taxes Act (1984) was passed by Parliament. The whole process had taken 6 months.

The exercise served a number of purposes. First, it demonstrated how unwieldy the Gambian revenue system had become. Numerous opportunities for rationalization were evident. As noted below several taxes were sales taxes that could be better administered by a single agency at a single rate.

Second, the exercise revealed a pattern of widespread evasion and under-performance. There were two problems. Revenue was not being collected, e.g., land rent, or, it was being diverted after it was collected. An example was the airport departure tax. Receipts more than doubled as soon as the customs took over its collection.

Finally, the report itself was an example of the benefits of economic analyses of alternative tax policies. Though the analysis undertaken was simple and straight forward, it was clear evidence of the value of regular systematic reviews of the impact and performance of revenue items.

b. The National Sales Tax

Based on work undertaken at the time the ERP was being formulated and continued during 1986 and 1987, a national sales tax act was passed in 1988.[17] Implementation began in 1989. The sales tax had two principal purposes. It would rationalize the revenue system by dispensing with more than a dozen special taxes. And, it would broaden the tax base. The impetus for the change was the realization that The Gambia had depended too heavily for too long on taxes on international trade. It was made more urgent by the progress of multi-lateral negotiations under ECOWAS[18] and the bilateral negotiations under the Senegambia Confederation. Agreements in these areas would have required The Gambia to reduce its external taxes for goods originating in ECOWAS countries and Senegal in exchange for similar treatment of goods originating in The Gambia.

Since The Gambia did not have a general internal tax, it faced the prospect of losing revenue as trade was diverted from its traditional suppliers to non-dutiable sources within ECOWAS. A broad based internal tax was needed to protect government revenue.

The government considered several options. One was a value-added tax (VAT). The advantage of a VAT is that a low rate of tax will raise large amounts of revenue because the tax has such a large base. The disadvantage is that a VAT requires every producer, processor and retailer to keep accurate and detailed records of their purchases and sales. Some reduction in the information required can be achieved if certain goods and services are exempted from the tax. For those goods and services which are not exempt, the record-keeping requirements are burdensome and, for The Gambia, unrealistic.

A second option was a consumption tax. It directly encourages saving and investment. When food is exempted, it also has a positive effect on equity. Its major disadvantage is that it is difficult to administer because it requires the taxation of all consumption transactions, most of which occur at the retail level.

The third option considered was a general sales tax. It would apply to as many goods and services as the government deemed administratively and politically feasible at the wholesale level. Like the VAT, its base is large. It is also easy to administer, particularly when applied at the wholesale/manufacturer level. The main disadvantage is that, with a flat rate, it is regressive if it is applied on staple items. A further disadvantage is that cascading of the tax occurs when retailers pay tax on commodities which have already attracted tax at the wholesale level. The problems of regressivity can be overcome by exempting particular goods from the tax, e.g., domestically-produced food and clothing, and adding excise taxes to goods and services, such as jewelry, perfume, liquor, or restaurant meals. The problem of cascading can be minimized by reducing the scope of the retail tax.

The MoF recommended the adoption of a general sales tax applicable at the manufacturer/wholesaler level. Specific provisions of the enabling legislation were:

- the rate of the sales tax was 10%;
- the sales tax would be administered by the customs and excise administration;
- exemptions from the tax would include specified educational, technical, cultural, religious and literary material; domestically produced food; some capital equipment; and medicines and health items;
- the import tax of 6% would be abolished, and to ensure that the general level of taxation did not increase the government would make compensating reductions in all tariff levels;
- the GAMTEL surcharge (10%); the insurance premium tax (10%); the air ticket surcharge (10%); the ad-valorem tax on hotel bills (5%); and the service charge on domestic tours (10%) would be replaced by the sales tax;
- the hotel bed tax of D3 per bed per day would be rescinded;
- Sales Tax would be applied to the domestic production of soft drinks and beer. An increase in the level of tax on these commodities would be avoided by lowering the excise by the equivalent of 10 percentage points; and
- requirements for registration of tax payers were set out in detail and under the Act penalties for evasion and fraud were strengthened.

The single uniform rate was an explicit attempt to minimize the administrative burden. Having customs and excise administer the tax was designed to improve enforcement. Import clearance could be withheld until sales tax arrears were cleared. The administrative burden was lowered further because the sales tax is being levied at the wholesaler/importer level. Thus, the customs administration would collect the bulk of sales tax revenue at the point of import. With this arrangement, compliance costs would be lower.

To reduce its regressivity, domestically produced food would not be taxed. Imported food, however, would be taxed. This was consistent with government's efforts to promote domestic food production, to encourage a switch in consumption from imported rice to local cereals, and to ensure that tourists who had the ability to pay, bear more of the cost of the imported food they consumed. With the passage of the national sales tax the hotels would be brought under the customs administration. Customs, therefore, would administer all indirect taxes on the hotels. That move would improve tax compliance. The hotels depended heavily on imports; they would not be allowed access to those imports while sales tax arrears persist.

Introduced in 1988/89, the sales tax has become a major source of government revenue. Table 5 has details for the three years 1988/89 to 1990/91. Over that period sales tax increased by 74% in nominal terms. By contrast net customs receipts increased from D320.5 million to D406.4 million, or 27%. The corresponding real increases were 54% and 7%, respectively.

c. The Revised Development Act

Through a series of development acts (1964, 1973, and 1988), the Gambia Government has, as a matter of policy, given away public resources in order to "develop" the country. This has been the rationale and the consequence of its Development Acts.

A major anomaly exists, however. Despite the large amounts of revenue involved, the government has never undertaken a detailed assessment of the relative costs of the investment incentives provided by its legislation. The Development Act (1988) was passed with no analysis of the benefits and costs of the Development Act (1973).

Questions such as: how much did the tax holidays and duty exemptions cost the Government?; how many loan guarantees were provided?; what other incentives and assistance were given to the investors who were "developing" The Gambia?; and what was their economic effect? Moreover, the basic question of why a new development act was needed was not addressed. Even though the government spent millions of dalasi promoting investment during the decade 1975/76 to 1985/86 yet economic growth had collapsed.

Table 5: Sales Tax 1988/89 to 1990/91

Items	1988/89	1989/90 (Dalasi millions)	1990/91
Imports	97.5	126.73	161.04
Manufacturers	3.64	6.7	7.64
Hotels	3.6	10.27	13.03
Tourist Enterprises	.32	.49	.59
Telecommunications	3.15	4.56	5.19
Insurance	.85	1.71	1.62
Air Services	2.97	5.50	4.93
Bars/Restaurants	.34	.86	1.01
Cinemas	.01	.05	.07
Night Clubs	.02	.04	.09
Casino*	---	---	---
Total	112.42	156.94	195.24
Internal Sales Tax (% of total)	13%	19%	16%

* Less than D10 thousand.
Source: Ministry of Finance and Economic Affairs, Macro Policy Analysis Unit.

Answers to those questions would have to begun to reveal that many of the loan guarantees ended up as bad debts which the government had to service through the managed fund, the Paris Club and the London Club. Many who held development certificates engaged in asset stripping, share dilution, tax evasion, the diversion of duty-exempt imported materials to other uses, foreign exchange scams, and transfer pricing. Close analysis of the revised Act, which was designed to improve transparency, had no effective penalties for malfeasance. Section 18 left the issue of restitution to the Minister's discretion. A more appropriate requirement in the case of default, would have been the full repayment of benefits received with interest at the bank rate. The revised Act also lacked any provision to require the overseeing ministry to regularly provide Parliament with estimates of the costs being incurred by the government through development certificates and the break-down of support for each enterprise. This would make the cost of that aspect of the Government's development assistance a matter of public record.

When some detailed analysis of the relative benefits of the development incentives provided by the government were examined closely, a widespread pattern of fraud and abuse and indifferent government oversight emerged.[19] Ten development certificates had been granted under the 1988 act. None of the certificate holders had complied with the provisions for reporting, monitoring, and economic performance. The government had not applied any sanctions. In effect, the 1988 act, like its predecessors, was a mechanism for transferring resources out of the public sector.

5. Computerization of tax administration

From their earliest exposure to Gambian tax questions, EFPA staff regarded computerization as a necessary, even if not sufficient, condition for systematizing income tax assessments and institutionalizing rudimentary tax policy analysis in the MoF. Project consultants showed income tax officials several uses for simple Lotus spreadsheets, operated on personal computers provided by the project and incorporating data from tax returns or, where appropriate, generating random samples of returns and then expanding these.

Among the uses demonstrated were: grouping returns and sorting them by various criteria, e.g. chronologically by taxpayer; calculating tax liability and discrepancies vis-à-vis manual assessments; cash accounting; and estimating the impact of alternative rate schedules on individual liability and aggregate collections. In 1985 one Gambian counterpart was assigned to the EFPA consultant concerned, and mastered several routines. However within a year he was assigned to a field post. His computer skills were not passed on to any colleagues.

A further effort to introduce computer skills in the ITD was made by including a special computer module in a year-long U.S. training program of a senior divisional officer. This was also unsuccessful.

Although the ITD eventually accepted a PC and a secretary used it for word-processing, seven years after the initial demonstrations none of the division's assessment work was computerized and no analysis was conducted on the machine. In late 1991 management allowed the intervening records to be entered on the computer for analysis as part of a new tax study,[20] but there was still no sign that the professional staff's traditional reticence before a keyboard would evaporate in the foreseeable future.[21]

6. Concluding Observations

Ten conclusions emerge from this review of the ERP's tax reform component:

- Tax reform aroused significant and concerted resistance. Examples include the long delay in amending the income tax; the hotel lobby's holding action against broadening the Sales Tax to include tourism; continuing resistance to computerization of the Central Revenue Department; abuse of development incentives; and government's unwillingness to invoke penal sanctions on the CRD's behalf.
- Penalty provisions of the tax code are never invoked. For example, nothing was done to correct major abuses uncovered by a study of the destination of duty-free imports.
- Arising from the widespread resistance, the pace of reform has been sluggish. All the reform measures eventually benefitted the economy, yet most took five years to implement.
- Donor community influence over the speed and direction of reform is strictly limited. Conditionality encouraged (and, in some instances, obliged) the government to meet specific deadlines for adopting laws or modifying regulations, but was insufficient to cause the new laws or regulations to be executed.
- The reform effort emphasized administrative efficiency. This involved simplifying the laws, eliminating ministerial and administrative discretion, broadening the base, and lowering the rates. For a period, tax compliance improved. In the case of personal income tax, this was a largely endogenous response to the lower rates and a changed posture of the Income Tax Division. In other cases, increased compliance, while it lasted, was to a greater or lesser extent a function of persistence by donor agencies and/or expatriate advisers on the ground.
- The positive revenue effect of improved personal income tax compliance more than offset the losses from lower marginal

rates. However, other components of the reformed tax system have begun to unravel. Enforcement of customs liabilities has regressed, and provisions of the Development Act have been perverted. These trends lead to distortions.

- Tax managers have almost uniformly resisted computerization. As of mid-1992, the Income Tax Department has still done nothing to computerize his operations; Customs dropped the compilation of indicative values as soon as MoF handed this function over to it; and the Development Act is still being administered manually.
- Failure to computerize compromises stated goals by delaying availability of data and obstructing cross-checks. Computerization will continue to lag as long as managers worry about improved information flows shifting the balance of power both within the MoF, where it permits easier sharing of data, and between tax administrator and taxpayer.
- Unless periodic analysis and review is built into the tax system, the system loses focus and drive. Notwithstanding several person-years of technical assistance, the MoF is still a long way from institutionalizing the process.
- When senior finance ministry officials lack orientation toward national development, the tax system will be perverted. The law simply becomes a set of loopholes serving partisan and personal ends.

There are several challenges for the future. Every country faces a choice between using its tax system predominantly (i) as a least-cost vehicle for raising the resources to support government expenditure, or (ii) as a means of channeling benefits to social groups in which vulnerable members of society are normally few and far between. If The Gambia wants to favor option (i), its tax administration some dramatic improvements will be needed. Among other things, computerization is essential. Conversely, sticking with option (ii) means continued dependence on external oversight to sustain the government's revenue base.

Endnotes:

1. Latham 1970, Cnossen et al. 1976; Abdel-Rahman et al. 1982.

2. Calculated from budget deficit and GDP series in IBRD World Tables 1991, (1991:260).

3. Calculated from Gray et al. 1992.

4. As of 1978 GPMB had reserves of D106.5 million (equivalent to $52 million or 31% of GDP). By 1981/82 they had fallen to D15.3 million; the next year the reserve account was overdrawn by D23 million.

5. McPherson 1984.

6. Perry 1985; Vincze 1987.

7. IMF 1982:44.

8. Gray 1985:7.

9. IMF 1982:42.

10. That said, it is difficult to believe that none of these employers were making undeclared payments to their high-level employees through foreign bank accounts, and that the employees were declaring all of their foreign property income to the Gambian authorities.

11. A more thorough study carried out by an HIID team in 1991 indicated that, for income-year 1989, ten persons taxed as employees reported a total of D246,000 rental receipts (one person accounted for 48% of this), and two individuals in a 29% random sample of self-employed taxpayers assessed by the Banjul office reported a total of D17,000. A separate sample, of 104 year-1989 taxpayers whose income tax liability had exceeded D1,000 in 1985, turned up two more individuals declaring a total of D45,000 in rentals. By contrast, HIID's two-person team alone paid about D90,000 in rents in 1989.

12. To soften the revenue impact of the reforms, repeal of the NDL was postponed until 1990.

13. As shown in IMF 1982:42.

14. Under the existing law, employer-provided housing was valued at a uniform D3000 per year. Needless to say this had long since been overtaken by inflation.

15. McPherson 1984.

16. Taxes are equitable if the burden is shared according to either the benefit principle or each taxpayer's ability-to-pay); they are effective if they achieve the desired fiscal objectives; and, they are efficient minimize the dead-weight loss.

17. Perry 1985; Vincze 1987.

18. Economic Community of West Africa States.

19. Gray et al. 1992:Section 4, Appendix 3.

20. Gray et al. 1992.

21. A reaction to the review of the tax system has been some enthusiasm for computerization of the tax system. A recent consultant report outlines what has to be done (Morrison and Owens 1992).

12

Customs Reform in The Gambia

Paul E. McNamara and Malcolm F. McPherson

1. Introduction

Much of the credit for the recovery of the Gambian economy rests with the policies included in the ERP. The recovery was also given a boost, however, by actions which were not part of the ERP. Customs reform is an example.

In framing the ERP, Gambian officials focused on the proximate causes of the economic imbalances - an overvalued exchange rate, negative real interest rates, excessive credit expansion, a bloated civil service, inefficient public enterprises, and unproductive public investment. The distortions created by these factors were obvious, evident, and public. Other distortions, such as customs fraud, which proved to be equally disruptive were not so obvious.

This chapter discusses the problems posed by customs fraud and the numerous and only partly successful efforts which have been made to deal with the problem. Section 2 examines the importance of customs revenue in the economy. Section 3 discusses the dimensions of customs fraud in 1986. Section 4 reviews the customs problems which emerged in 1988. Section 5 examines why customs fraud has proven to be such a difficult problem. Section 6 has concluding comments.

2. Customs Revenue in the Gambian Economy

The Government of The Gambia has always derived the bulk of its revenue from customs receipts.[1] For the period 1965/66 to 1988/89, customs revenue averaged 65% of government revenue. The degree of dependence has not changed significantly. In 1965/66, it was 59%; in 1970/71, it fell to 45%, while in 1988/89 it was 74% (Table 1).

The government's continued dependence on customs revenue results from administrative, economic, and geographical factors. The lack of appropriate records among private entrepreneurs has limited the scope for introducing a broad-based sales tax.[2] Economically, the country's small industrial base, low levels of productivity in both agriculture and industry, small wage labor force, and slow rate of economic growth have provided few opportunities to increase the contribution from direct taxes. Geographically, The Gambia is ideally located to provide entrepot services for West Africa. Customs duties, therefore, continue to be one of the easiest and cheapest ways of raising revenue.

There are evident risks of remaining so heavily dependent on one revenue source. The government's budget deficit, its borrowing requirement, and domestic credit creation are directly tied to the buoyancy of international trade which is largely outside government control. Moreover, trends in the deficit and government borrowing, in turn, affect inflation and the balance of payments. That is, some of the major macroeconomic aggregates are sensitive to changes in customs revenue.

Table 1: Customs Revenue in The Gambia Selected Years

Year	Imports (cif)	Import Duty	GDP	Govt. Rev.	Duties/ Govt. Rev.
1965/6	29	8	100	14	59
1970/1	43	12	133	87	45
1980/1	263	48	409	80	60
1981/2	241	56	461	91	61
1982/3	262	73	528	105	69
1983/4	347	79	599	128	62
1984/5	359	89	673	148	60
1985/6	494	138	859	216	64
1986/7	860	234	1078	318	74
1987/8	869	226	1251	329	69
1988/9	1056	220	1512	451	74
1989/0	1507	217	1793	508	43
1990/1	1805	234	2057	533	44

Source: Ministry of Finance and Economic Affairs, GDATA file.

3. Customs Fraud I - 1985/86

The IMF mission in December 1985 noted that the performance of government revenue had been poor in the first half of the year. Without remedial action, the government would not meet its deficit target. The mission pressed the minister of finance to take extraordinary measures to cut expenditure and raise revenues through a "mini-budget". That would have been unprecedented in The Gambia. It was resisted because it posed serious administrative and political problems.

The government had some room to cut expenditure but it would have been almost impossible to raise additional revenue through higher taxes. Import duties had already been increased several times in the recent past. Moreover, the limited revenue response from those increases had been limited there was considerable doubt that higher taxes would have the desired effect.

The minister of finance directed his staff to examine the causes of the revenue shortfall. Because of the importance of customs, the examination began there.

According to the senior staff of customs and excise who were interviewed at the time, the revenue performance reflected normal seasonal factors and sluggishness in the traditional re-export trade. They were confident, however, that there would be a major improvement in the second half of the fiscal year. Data they presented seemed to provide some support for their views.[3] These data, however, were inconsistent with other evidence available to the ministry. Trading activity was high, the port was clogged, and the airport had been busy. Ministry officials (including the minister) also had information from a variety of sources the fraud was widespread in customs.

Direct evidence that something serious was amiss came to light when a local businessman provided photocopies of false invoices to the minister's staff. He had obtained the material from a disaffected customs officer. This evidence was suggestive, but if action were to be taken, the minister needed additional information.[4] The problem was for the minister's staff to gain access to customs records without alerting senior customs and senior ministry officials that an investigation was underway.

Access to these records was gained through the trade division which normally receives separate copies of every customs entry. Although intended for analysis of trade flows, these entries provided a complete summary of the declarations which importers and exporters had made to customs and which the customs administration had accepted. With these records, it was easy to determine that customs fraud was rampant. The main problem was undervaluation.

Determining the extent of undervaluation proved to be a problem. Few reliable data on values and quantities existed since by late 1985, customs fraud had become well entrenched. The data provided by the few traders who were not involved in the fraud were useful but inadequate. Ministry officials turned to the diplomatic community for assistance. Their sources proved to be highly valuable.

The entire import record for 1985 was reworked. Undervaluation was extensive and covered every dutiable commodity imported into The Gambia except petroleum.[5] Estimates showed that, at a minimum D35 million, or approximately 40% of customs revenue in 1985, had been lost through undervaluation.

A report was delivered to the minister in January 1986. It gave details of the importers and commodities involved, the dates, the amount of duty actually paid, and an estimate of the duty which should have been paid. The minister sent a copy of the report to the president. A revised version, which omitted names and dates, was circulated to the permanent secretary, the comptroller of customs, and other officials.

The minister then held a meeting at which he instructed the comptroller and the permanent secretary to ensure that the fraud was ended forthwith and that all outstanding revenue from 1985 was collected. The minister also contacted the attorney general to enquire about his powers in the matter. The law, he was informed, contained adequate provisions.[6] That none of these would be enforced emerged only later.

A major uncertainty at the time was how the president would react once pressure about the crack-down began to build from traders, many of whom were well-connected, politically prominent, and generous supporters of the main political party. The president's options were narrowed considerably, however, by an offer from the UK minister for overseas development, who was visiting The Gambia for independence day celebrations, of technical assistance to deal with the fraud.[7]

Minister Sisay took advantage of the offer and within weeks a UK customs officer arrived in The Gambia. He confirmed that undervaluation was the major problem. His report to the minister found numerous other problems with the customs administration.[8] He recommended that extensive changes be made including the appointment of a UK customs officer with responsibility for customs valuation and investigations. (Annex A gives the report's main points.) Cabinet endorsed the report and preparations were made to identify the technical assistant.

Because fraud had become so entrenched in customs and the senior customs management would not deal with it, the trade division of the ministry of finance took over responsibility for customs valuation. A list of indicative values was compiled from a variety of local and external sources. The list was regularly updated. The arrangement persisted from March 1986 until the UK customs officer arrived in November 1986. At that point, the ministry turned over to customs the monitoring of import entries and the compilation of indicative values.

With these arrangements in place, Minister Sisay fully expected that the problem of customs fraud would be kept in check. As a result of the crack-down on undervaluation, revenue increased dramatically and the budget deficit fell (see Table 1 for details). Indeed, customs revenue improved to such an extent that most customs duties were reduced by an average of one-third in the 1985/86 budget. Even with this change, real customs revenue was higher in 1986/87 than in 1985/86.

These improvements had been generated entirely through reductions in fraud from February/March 1986 onward. None of the revenue lost was recovered. In retrospect, this was unstable. Since no one was penalized for their earlier transgressions there was no incentive for anyone to resist fraud if opportunities arose again. The lack of sanctions simply set the stage for continued fraud.

4. Customs Fraud II - 1988

From November 1986 to early 1988, senior Ministry officials had no direct involvement with customs operations. Revenue collections remained high and there were no obvious signs or reports that anything was amiss.

Problems emerged in March 1988. Several local traders began protesting to the ministry that an importer was engaging in re-export operation under the pretext that the goods were being transitted.[9] The importer would store sugar, textiles, cigarettes and other commodities in a bonded warehouse and periodically apply to the comptroller of customs for the release of some of the goods for transit to neighboring countries. Some of the goods supposedly "in transit" were also being sold locally.

After much dithering by senior ministry officials, a meeting was held. The minister heard all views regarding the practice. He instructed that the importer who was running the phoney transit trade be allowed to transit the goods he already had in storage (several million dalasis worth), but that the practice be stopped after that.

Annoyed that his activities had been curtailed by the complaints from his competitors, the importer began to systematically expose their fraudulent practices. His allegations, most of which were subsequently verified, were extensive. The most serious was that several traders, with the complicity of customs officials and shipping agents, were removing portions of ships' manifests. That action erased the most important evidence that the goods had actually been delivered to The Gambia. This method of smuggling had been occurring on a large scale.[10]

Numerous other stories of customs fraud, involving mis-specification, undervaluation, short-landing, and under-quantification among others, began to emerge. Some of these reached the president, who summoned the minister of finance to explain.

The minister who had been briefed by his staff that their preliminary investigations had shown serious problems existed in customs, responded by establishing a "special team" to review the allegations and report back within a month. The team, which was headed by the UK customs advisor, also included two ministry officials and one expatriate advisor. It was instructed to:

- verify declarations of imports against shipping records;
- document instances of undervaluation, underdeclaration and nondeclaration of imports;
- update the list of indicative values for goods commonly imported into The Gambia; and,
- recommend solutions sufficient to address the problems uncovered.

The team concentrated its investigation on three areas: undervaluation, problems with the transit facility, and, abuses of the direct delivery facility for bulk commodities.[11] Team members assembled and compared data from customs, shipping agencies and the port authority. They also obtained data from interviews with business people and customs agents.

The investigation brought quick results. Revenues for September 1988 were 40% higher than their levels in July and August. Some of that improvement was due to the collection of outstanding amounts owed on goods taken on direct delivery but some represented a reduction in fraud. Within a week of embarking on the investigation the team found cases of undervaluation and abuses of the transit and direct delivery facilities. The team recommended the withdrawal of the direct delivery facility, the reassignment several of customs officials, and reallocation of key duties. Customs valuation was turned over to an officer with a reputation for honesty.

At the end of the month-long investigation, the team presented its report[12] to the president who, due to the Minister Sisay's illness, was acting minister. The team found a total of D32 million of fiscal year 1987/88 revenue which the customs administration had failed to collect. Smuggling at the Amdalai border post had cost D11 million. The abuse of the direct delivery facility accounted for an additional D14.6 million. Further losses occurred through undervaluation. These amounts represented 15.5% of customs revenue for that fiscal year.

In response to the report and its recommendations, the president as acting minister fired the top four customs officers. He placed a ministry of finance official in charge of customs on an interim basis and directed him to collect the missing revenue. It was decided not to take legal action or apply punitive sanctions against those listed in the report.

Although the special team covered a lot of material in a short time, its handling of undervaluation was incomplete and flawed. It has also been unable to update the list of indicative values. These points were noted by the minister of finance when he reviewed the report upon his return to duty in November 1988. As a means of getting to the bottom of the issue, he ordered that a further review be conducted and all areas of customs abuse be examined.

A team began work immediately. They documented undervaluation and other fraudulent practices which had cost the government over D45 million (approximately 13% of customs revenue) during the period of January 1987 to June 1988. The report which ran to more than 200 pages identified many instances of fraud in addition to undervaluation. It took 5 months to complete.[13] In the interim, Minister Sisay had resigned due to ill health. The report was delivered to his successor.

The team recommended that the customs advisor and two other customs officials be asked to explain how such large scale fraud could occur without them noticing or taking action to deal with it.[14] As noted earlier, the customs advisor was responsible for valuation and investigation. Had these duties been performed effectively, the government would have saved millions of dalasis.

The recommendation that the customs advisor be held to account created a diplomatic flap. The British High Commissioner complained to the US Ambassador and USAID Representative. The issue was not whether customs fraud had been perpetrated. The High Commissioner was annoyed that one of his technical assistants has been criticized.[15] Unfortunately, the diplomatic side-show diverted attention from the central point of the report that customs fraud had, once again, been massive.

Since the team submitted its report, the government has taken no action on the issue. In June 1990, 15 months after the report had been submitted, cabinet endorsed a memorandum by the minister of finance that the director general of customs (as the former comptroller has now been called) be left to determine how to proceed. In effect, the minister, with cabinet's concurrence, killed the report.

Nonetheless, customs fraud has not ceased. At the insistence of the World Bank, the government eventually agreed to another investigation. The UK government supplied a team of two customs auditors. Their report was delivered in early 1992.[16] It recounts in detail, yet again, major areas of fraud. The losses of revenue were again millions of dalasis.[17]

5. Evaluation of Efforts at Customs Reform

The various investigations of customs produced some concrete actions and temporary remedies. The 1985/86 episode led to the compilation of the list of indicative values, the provision of technical assistance to the customs, and some additional training for customs officers.[18] But, none of those who perpetrated the fraud was punished.

The September 1988 report provoked a quick response by the president. The four most senior customs officials were fired. However, no other punishments ensued. Once again, there was a positive revenue impact but nothing concrete was done to discourage traders from future fraud.

The March 1989 report was ignored.

Overall, the actions which followed the various customs investigations did not address the source of fraud. In effect, customs <u>reform</u> did not occur despite the overwhelming need for it.

Indeed, the 1992 report on customs made the point that almost none of the substantive recommendations made in any of the previous investigations had been implemented. It is not surprising that customs fraud remains a major recurrent problem.

The reason is clear: no one in any position to make a difference has had the incentive to deal with the problem. Throughout the whole process, Gambian policy makers have had goals other than the prevention of fraud. Indeed, the reverse is the case - too many have benefitted for the fraud to stop.

In 1985/86, the customs investigation was incidental to the problem of reducing the budget deficit and deflecting IMF pressure for drastic changes in fiscal policy. Expenditure cuts would have been difficult and unpopular and increases in taxes were seen as infeasible. Therefore, revenue collection had to improve, With the dramatic increase in revenue following the crack-down on fraud in February 1986, there was less pressure to deal with those who had cheated the government. The minister of finance, in particular, was not eager to take legal action. He was concerned that it would divert attention from the more pressing policy changes which were needed to continue the implementation of the ERP. He expected that by exposing the fraud and bringing in technical assistance, traders and customs officials would "mend their ways."

Although his response was pragmatic, his expectations were naive. The same traders who were cheating the government in 1985/86 were also implicated in 1988, 1989, and 1992.

The situation in 1988 was different. Senior ministry staff were rumored to have abetted the "phoney transit trade." Furthermore, with an ex-patriate customs advisor "on the job", fraud of that nature was not supposed to get out of hand. Those who believed the rumors were skeptical that the ministry would take any action; others who had confidence in the customs advisor were complacent. The September 1988 investigation occurred only when the minister could no longer deflect attention from the issue. Further work was ordered in November 1988 because the mis-representations regarding undervaluation in the earlier report were too glaring to dismiss.

The lack of action on the March 1989 report was consistent with new minister of finance's agenda. For him, customs reform was not a priority. Indeed, the 1992 report has the opposite conclusion.

6. Concluding Observations

In The Gambia, the government has shown no interest in dealing effectively with customs fraud. The problem has been addressed on an intermittent basis only when the loss of revenue has seriously affected overall macroeconomic performance. On the occasions when

action was taken, it was to meet other objectives. In 1985, it was to reduce the fiscal deficit; in 1988, it was to deflect political pressure. In 1991, it was to meet a World Bank condition.

The initial action to reduce customs fraud in early 1986 had a major impact on the success of the ERP. The improvement in government revenue reduced the budget deficit, lowered the growth of credit, and helped stabilize the exchange rate. Later, in 1988, the increase in customs receipts led to a substantial increase in official foreign exchange reserves.

For policymakers interested in administrative reform, there are some several lessons that can be derived from the episodic crack-down on fraud.

First, the revenue gains from reductions in fraud can have major benefits to the macroeconomy. The ERP would have been in deep trouble in early 1986 without the improvement in revenue associated with the reduction in customs fraud.

Second, the effects of the actions taken to expose and reduce fraud were diminished because there was no concerted attempt to institutionalize improvements in valuation and monitoring. Allowing the indicative values to become out-of-date was simply irresponsible.

Third, the failure to penalize traders and customs officials for their fraudulent actions was a mistake. Customs fraud, in retrospect, has been a major means of boosting private fortunes in The Gambia. Relative to government revenue and GDP the amounts have been large. The absence of sanctions has reinforced the all-too-common perception in The Gambia that being honest is being stupid.

Fourth, it is a mistake to presume that technical assistance and technical assistants will deal effectively with problems such as corruption. Technical assistants are rarely, if ever, held accountable for their non-performance. Periodic, honest, evaluations of the value of <u>all</u> technical assistants should be a standard practice.

Fifth, those who are promoting reform in an environment such as The Gambia, where honesty is not even thought to be one of the better strategies, should be prepared for limited progress and frequent set backs.

Sixth, the attitudes of the donor community to the issue of fraud should be made explicit. Gambian policy makers could ignore the potential revenue gains from the collection of unpaid customs duties secure in the knowledge that the donors would make up losses with additional aid. Were the donors serious about engaging the government in addressing the problem of customs fraud, they would

make their aid contingent on the government's revenue performance. So far, donors have been prepared to bear responsibility for all of the revenue short-fall.

Seventh, the recurrence of problems in customs (and elsewhere in the revenue agencies) indicates that there is no internal mechanism within the government to detect and correct major abuses. Donor pressure has been the only remedy so far. Until the government establishes some internal mechanism, the donors (by default) will have to continue to police the situation.

Finally, however the donors continue their oversight, any reforms which are introduced will have to take into account the general lack of accountability which characterizes the whole public sector in The Gambia. Corruption has become entrenched. For those Gambians who are genuinely interested in addressing this problem, customs would be an ideal place to start. It has macroeconomic significance, and fraud is a recurrent phenomenon. Sustained improvements in this area would signal that The Gambia is, after numerous halting steps, on the path to reform.

Annex: The Kellaway Report (April 1986)

The report assessed the situation in the customs administration. It highlighted the major weaknesses; indicated where performance was satisfactory; and offered suggestions for constructive change.

Major difficulties were:

- the system of direct delivery offers no scope for verification and detection of fraud;
- the Valuation Section is at present dysfunctional -- no effective check of values is being made;
- some Customs outposts have no real purpose;
- there is no system for regular checks of shipments along the Trans-Gambia Highway;
- the mobility of Customs officers at outpost stations is severely restricted through lack of transport (cars and bikes);
- while numerous Customs officers have been sent for training, there has been little effective use made of the skills they have acquired;
- Customs officials lack basic aids for measuring and verification; their communication equipment is poor and inadequate;
- there is little scope for broader cooperation on Customs issues because The Gambia is not a member of the Customs Cooperation Council;
- most Watchers are illiterate and and many are innumerate as well;
- there is no formal scheme for rotating staff to ensure that opportunities for fraud and malfeasance are minimized.

Areas of satisfactory performance:

- the level of staffing is not excessive and major redundancies are not evident;
- despite its limited staff, the jerquing section functions creditably;
- the Mobile Unit, though small, is effective when it is deployed; and
- the Manufacturing Industries eg. the brewery and the bottling factory seem to be properly covered.

Suggestions for change and improvement were:

- the direct delivery of goods should be suspended and a system based on appropriate valuation and bonds be introduced;
- the Valuation Unit should be restructured and procedures implemented for proper verification of declared values;
- The Gambia should join the Customs Cooperation Council and to avoid arbitrariness and potential fraud, the values of all vehicle imported into The Gambia should be derived from Glass's Guide;
- the activities of various units in Customs should be regularly inspected;
- selective rummage of ships and aircraft should be undertaken;
- the equipment used by Customs staff (vehicles, bikes, measuring apparatus, and communication equipment) should be increased and upgraded;
- senior staff should be given management training and other staff who have been trained should be more effectively deployed;
- a second Mobile Unit should be established and based in the Provinces;
- penalties for under-declaration and Customs fraud should be strengthened with the addition of gaol sentences; and
- an expatriate customs expert with direct line responsibility for Valuation and investigation and who reports directly to the minister of finance and trade should be appointed as soon as possible.

Endnotes:

1. Between 1900 and 1936, customs revenue averaged 73% of total government receipt (Frankel 1938:Table 82).

2. A great deal has been made of this difficulty in The Gambia. Much of it is a smoke-screen for inaction. Gambian entrepreneurs are often illiterate; they are never innumerate. None of our research revealed examples where an entrepreneur had made a mistake in favor of the government.

3. The Customs and Excise Administration, unlike other agencies of the government, kept up-to-date records of all customs transactions on a daily basis.

4. Soon after his arrival in mid-1982, the minister had requested his senior staff to review and report on the activities and performance of customs. The report took several months to prepare. It showed that, apart from minor difficulties, the customs administration was sound and productive. The minister knew that the report had been a whitewash but understood that his staff of the time would not find otherwise.

5. Petroleum had been imported by the major companies (Shell, Texaco, and BP) or through special arrangements from Senegal. Fraud in this area occurred <u>after</u> the petroleum had been imported through the duty waiver system. Dealing with this issue required a separate enquiry.

6. The Customs Act (cap.43) and Customs Regulations Act (cap.44) in The Gambia were derived from an earlier UK legislation. If their provisions had been enforced, fraud would have ended abruptly.

7. The possibility of such assistance had been raised by the British High Commissioner who had been aware of the investigation and had been briefed on its progress by Minister Sisay. The offer in effect informed the president that the UK government was well aware that The Gambia, while expecting assistance from the UK, and other donors could take measures of its own to improve its revenue performance.

8. Kellaway 1986.

9. This issue had already been investigated within the ministry in January 1988. A memo to the permanent secretary outlined the nature of the activities and the threat they posed to the re-export trade itself from which a large part of government revenue was derived. The memo recommended that this "phoney transit trade" be stopped. No action was taken.

10. Smuggling was also occurring at the border posts with goods being transitted from Senegal. For a small payment to customs officials the number of containers and their contents would not be entered in the official log book.

11. Direct delivery refers to the practice of allowing importers to take delivery of commodities, typically those which are bulky or perishable, without paying duty. The customs formalities and payments are completed after the importer has possession of the goods (and almost invariably has sold them). The system is a direct subsidy to importers by the government amounting to the value of interest earnings on outstanding duties which are eventually paid. For those who fail to pay, the subsidy is the total duty owed. The system was widely abused.

12. Homan et al. 1988.

13. McPherson, Jabai, and McNamara 1989. Updating the indicative values proved to be a major operation. These had not been revised since they were turned over to customs in November 1986.

14. The report refuted the conclusion of the September 1988 investigation that undervaluation was not a significant problem.

15. It is worth noting that the fuss arose <u>before</u> members of the diplomatic community had actually read the report.

16. Dunlop and Livings 1992.

17. The director general was recently sent on leave (mid-1992) and an investigation of his behavior was initiated.

18. The EFPA project supported the training of two senior customs officers in the UK. A secondment with the US Customs Service was being arranged for the Deputy Comptroller at the time the September 1988 scandal broke. The arrangement collapsed when he was fired.

13

Recurrent Costs and the Public Expenditure Program

Malcolm F. McPherson

1. Introduction

The ERP gave special prominence to the reorientation of the public investment program (PIP). There were two reasons. The government could no longer postpone dealing with the public sector's acute recurrent cost problem. And, the efficiency of public investment activity had to be increased. Without action in both areas, sustained economic growth, the second objective of the ERP, could not be achieved.

This chapter examines how the ERP sought to redress the recurrent cost problem and improve the efficiency of public investment. Section 2 discusses the recurrent cost problem. Section 3 examines trends in public investment. Section 4 reviews attempts to implement public expenditure programming. Section 5 has concluding comments.

2. The Recurrent Cost Problem

a. General Dimensions of the Problem

The recurrent cost problem refers to the chronic underfunding of operations and maintenance expenditure (O&M).[1] At its most basic level it reflects a persistent distortion in the allocation of government resources which undermines the efficiency of the public sector. Capital is used inefficiently because maintenance is delayed; and civil servants are less productive because they do not have the appropriate material with which to operate.[2]

The problem can arise in two ways. First, there may be adequate resources available but , they are allocated in ways that lead to a deficiency in O&M. Second, all public resources may be in short supply, including those devoted to O&M.

Potential solutions in both cases differ. In the first case, the problem is to improve the allocation of public resources. A well-known result in welfare economics is that public resources are allocated efficiently when the marginal contribution to social welfare is equalized across expenditure categories. In practice, that criterion is widely ignored. Movement toward this ideal in a country with a recurrent cost problem would require policies that cut other items of public expenditure, such as salaries, and reallocated them to O&M. Such changes are difficult to implement. Vocal lobbies exist to defend expenditures on salaries. No such lobby exists to defend O&M.

In the second case, the problem is the direct result of the country's low income of the government's unwillingness to tax.[3] A solution would require improvements in the efficiency with which all public resources are used. Borrowing and/or higher levels of aid, at best, can be a temporary solution. Over the longer term,

the problem can be resolved only through increased public sector revenue derived from sustained economic growth.

In general, however, solutions to the recurrent cost problem will involve both the expenditure and revenue sides of the public sector budget.[4] Attention therefore has to focus on ways of improving resource allocation and raising additional resources.

b. The Recurrent Cost Problem in The Gambia

The Gambia has had a serious recurrent cost problem since the mid-1970s.[5] The first five-year plan led to a sharp increase in the scope and volume of public investment. The recurrent resources needed to support that investment did not increase commensurately. During the expansion phase, there were adequate resources for a wide range of activities - employment creation, the establishment of public enterprises, loans to public sector employees, international travel, consumer subsidies, and public investment. Lack of resources was not a problem; using them efficiently was.

The data in Table 1 provide some perspective. They are estimates of the recurrent cost ratios for the whole public sector as well as agriculture, transport and communications, and social services (i.e. health and education). The ratios are calculated as the annual expenditure on O&M in each sector relative to the capital stock in the preceding period.[6] The most notable feature of the data is the sharp decline in the ratios after the mid-1970s. This reflects the rapid increase in capital expenditure and the underfunding of recurrent costs.

In physical terms, the recurrent cost problem has been evident in two ways. First, public sector capital, such as roads, bridges, buildings, and drainage systems, have deteriorated. Second, public sector employees have had frequent difficulties obtaining the supplies, fuel, and spare parts needed to complement their work. Neither of these effects are particularly easy to measure, except in relation to some established historical ratios.

Another indicator of a recurrent cost problem is whether public sector capital has to be replaced because of physical neglect rather than obsolescence. There are few examples in the latter category. The electric generators at Bansang and the printing presses at the Government Printing Office are two.

It has been far more common for public sector capital to have been replaced or re-built because it has deteriorated beyond repair. In effect, capital expenditure has been substituted for recurrent expenditure after-the-fact. The bus fleet operated by the Gambia Public Transport Corporation had declined to 6 units prior to the arrival of the M.A.N. buses donated by the German government in 1985. The lack of maintenance at the Gambia Utilities Corporation has led to the periodic crack-up of generating equipment. The

Table 1: Government Capital Expenditure and Recurrent Cost Ratios, The Gambia

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
GOVERNMENT CAPITAL EXPENDITURE	(Dalasis millions -- current prices)													
Government Investment	6.3	3.1	11.3	69.8	68.8	43.8	70.1	109.1	91.3	153.3	188.2	141.1	160.5	177.7
Agriculture & Nat. Resources	0.5	0.4	1.9	7.2	5.7	1.6	16.8	12.1	40.8	60.3	45.1	19.0	14.0	27.9
Industry and Mining	0.5	0.3	0.3	1.0	0.1	0.7	1.7	17.0	4.3	9.3	0.0	0.2	0.2	0.0
Tourism, Trade and Finance	0.0	0.0	0.0	1.4	0.5	1.4	5.3	1.3	10.3	0.5	0.9	0.3	1.7	2.7
Public Utilities	0.5	1.0	0.6	3.1	6.6	4.2	7.7	1.9	24.6	16.4	5.1	19.1	37.0	33.7
Transport & Communications	2.0	0.5	3.8	34.0	22.8	18.8	35.3	52.3	0.2	45.1	61.0	69.7	63.5	61.3
Social Structure	0.0	0.3	2.2	14.4	26.6	14.5	3.0	21.1	1.3	16.0	66.6	23.7	31.5	37.3
Adminis., Security & Justice	2.5	0.5	2.5	4.2	6.2	2.6	0.3	3.5	4.2	5.6	9.5	9.1	12.6	14.8
Other	0.3	0.0	0.0	4.6	0.0	0.0	0.0	0.0	5.1	0.2	0.0	0.0	0.1	0.0
Government Capital Stock (10% depr.)	(Dalasis millions -- constant 1976/77 prices)													
Agriculture & Nat. Resources	5.1	5.6	10.1	42.9	43.4	40.4	48.2	51.2	66.7	85.6	94.3	91.3	86.4	85.1
Transport & Communications	20.4	26.1	36.4	125.2	132.1	134.6	146.1	165.3	148.8	153.1	161.2	168.6	170.7	169.9
Health & Education	9.0	7.3	11.2	37.4	56.3	62.8	58.6	66.4	60.4	61.2	80.6	80.6	81.9	83.6
Other Capital	30.2	35.9	40.1	89.3	95.9	97.9	103.2	112.8	131.2	136.9	135.3	138.0	146.0	151.5
Aggregate Capital	64.7	74.8	97.9	294.8	327.6	335.8	356.1	395.8	407.2	436.8	471.5	478.6	485.0	490.2
RECURRENT COST INDICATORS*														
Public Sector	0.34	0.54	0.50	0.26	0.34	0.24	0.22	0.19	0.14	0.17	0.24	0.16	0.18	0.15
Agriculture	0.48	0.57	0.66	0.29	0.18	0.20	0.19	0.15	0.11	0.06	0.06	0.05	0.06	0.05
Transport & Communications	0.32	0.32	0.38	0.11	0.11	0.09	0.07	0.06	0.03	0.03	0.04	0.04	0.03	0.03
Health & Education	0.48	0.97	1.11	0.78	0.67	0.47	0.40	0.43	0.30	0.30	0.31	0.29	0.38	0.34

* [Recurrent expenditure (t)/Implicit GDP deflator (t)]/Capital stock (t-1)

Sources: Ministry of Finance and Economic Affairs, Macro-Policy Analysis Unit, GDATA91 spreadsheet
Central Statistics Department, Republic of The Gambia

generators then have had to be replaced. The Gambia River Transport Company's fleet of tugs and barges have been in such poor shape that it became impossible to use the river to evacuate the groundnut crop. The system of roads and drains in and around Banjul were so degraded over the period 1979 to 1987 that the major roads had to be rebuilt and alternative drainage systems constructed. The airport was so poorly maintained that its international accreditation was almost withdrawn on several occasions.[7] The Gambia Ports Authority experienced serious difficulties maintaining regular ferry services at Banjul and Farafenni. Several up-country ferries were regularly out of commission. Finally, many government buildings were in advanced states of disrepair.

Nonetheless, the public sector capital stock had not been uniformly neglected. Some facilities and capital items have been well-maintained. The State House and its surroundings, vehicles used by senior government officials, and the head offices of the largest parastatals are examples.

c. Consequences of Underfunding Recurrent Costs

The underfunding of recurrent costs has a differential impact on the economy. The lack of supplies has an immediate effect on the efficiency of public sector employees. Without stationery, government correspondence lapses, taxes cannot be collected, memos written, bills delivered, or information shared. Without books and writing material, schools become ineffective as institutions of learning. Without fuel, power cannot be generated, water cannot be pumped, garbage cannot be collected, and border customs posts cannot be staffed. And without medical supplies, basic health services cannot be provided.

During the latter part of 1984 and throughout 1985, The Gambia experienced many of these problems. Fuel, in particular was regularly unavailable. Periodic rice shortages occurred.[8] The government often ran short of office supplies, vehicle spare parts, and medicine. But again, the shortages were not universal. The State House always had electricity and its vehicles always had fuel. Most senior civil servants could find the resources needed to travel abroad.

Over the longer term, the deterioration of the capital stock began to incur costs on a wide front. Vehicles depreciated more rapidly because of the rutted roads, business and personal interaction took more time and effort because of the break-down in transport services and telecommunications, medical risks increased because of the deterioration of the hospital system, and electrical equipment burned out with greater frequency because of brown-outs and black-outs. Some of the costs associated with these difficulties could be deflected by appropriate adjustments. For example, vehicles were driven more slowly, and back-up electricity generators could

be installed. All such adjustments entailed dead-weight losses. The adequate funding of recurrent costs would have made them unnecessary.

The main economic effect of these factors was to reduce the overall level of productivity in the economy which, in turn, lowered the rate of economic growth. A detailed model would be needed to untangle the various effects of recurrent costs from other influences. Nonetheless, it is hard to argue that the recurrent cost problem was an unimportant factor in the dramatic reduction in the productivity of capital in The Gambia from the mid-1970s onward. To illustrate, the aggregate capital/output ratio was 2.8 for the period 1965/66 to 1975/76, but increased to 7.6 in the period 1975/76 to 1985/86.

d. Reasons for the Recurrent Cost Problem

The principal cause of a recurrent cost problem is budgetary. Because of allocation problems or the general lack of resources, the government does not provide adequate funding to maintain the public sector capital stock or to complement the activities of public sector employees. The problem arises for a variety of reasons.

First, the government attaches a low priority to funding O&M. When budgetary pressures emerge, O&M are often the first to be cut. Since roads and bridges, once built, take time to wear out, it is tempting to postpone routine maintenance. Similarly with tugs, cranes, and electricity generating equipment.[9]

Second, although some important changes have occurred over the last decade, donors still focus on capital expenditure. Moreover, despite overwhelming evidence to the contrary, donors have continued to assume that the normal operating costs of development activities will be met by the government, if not during the early phases of a project, then ultimately.

Third, donor assistance to the government creates serious distortions in the relative costs of resources. Because it is poor, The Gambia receives grants from most bilateral donors and highly concessional loans from the multilateral agencies. These resources typically cover the cost of capital equipment and imported commodities. Their opportunity cost for the government is low and often zero. By contrast, for the government to augment its recurrent resources it has to raise taxes and/or borrow and/or cut its other expenditures. All of these are unattractive options which have high opportunity costs. Viewed from the government's perspective, it is perfectly rational not to fund the recurrent costs of donor-supported investment.

Fourth, because donors regularly cycle their staff and change their focus of their support, they have limited leverage over the

government regarding its agreements to funding recurrent costs. By the time the agreements become operational, the donor staff have departed and their replacements often have different priorities. The outcome is that the capital created through development projects is virtually never adequately maintained. Moreover, if the project activities are to continue, additional donor assistance is typically required to "rehabilitate" or "expand" them. Prominent examples in The Gambia are the Oyster Creek bridge, the ferry crossing at Farafenni, and the Banjul-Serekunda road. None of these was properly maintained. Eventually they were rebuilt.

Fifth, due to the pressures associated with the need to be seen to be promoting development, the government has substituted quantity for quality. For instance, the commitment to education has often been framed in terms of schools built and teachers hired. That the schools have been short of furniture, supplies, and books and have had to use unqualified teachers has been of secondary importance.

Sixth, the economic crisis of the 1980's highlighted a related dimension of the recurrent cost problem. The shortage of foreign exchange prevented the foreign component of recurrent expenditure from being met. Indeed, it compounded the problem. With the dramatic depreciation of the dalasi after the float, expenditures on "Other Charges" increased sharply. In 1987/88, for example, this component of the budget was over-spent by 18%, although there had been an increase in the budgeted allocation of 25% during the previous year.

Finally, the appearance of a recurrent cost problem may arise even in cases where the government has made adequate funds available. Problems arise because recurrent resources are diverted to other uses. Government drivers regularly pilfer petrol and substitute used parts for new ones on vehicles; medical workers divert government drugs to the local market; office assistants supplement their incomes by selling office supplies; office phones are used for private purposes; and so on. These problems are often compounded because recurrent costs are not adequately funded in other areas of the government. For instance, the pilferage may increase because those involved know that government auditors do not have the resources (typically vehicles and fuel) to make spot checks.

3. Public Expenditure Programming

a. The Objectives

Public expenditure programming is the latest in a series of initiatives which have been used by the donor community to encourage the government to improve the allocation of public resources. The first such initiative, which emerged in the late 1970s, involved the adoption of a sector-by-sector approach to the

recurrent cost problem. That approach had been worked out as part of a broader study of recurrent costs in the Sahel.[10]

The effort failed. Indeed, it is fair to say that it made no impression whatsoever on those involved in budgeting or planning. Neither the second five-year plan nor the mid-term review of the second plan dealt with the recurrent cost issue in any detail.[11] The essence of the mid-term review was a major expansion in public sector investment designed to reverse The Gambia's poor growth performance. In view of the acute nature of the recurrent cost problem at the time such a massive expansion in public expenditure (D1.15 billion over four years), would have simply compounded the problem.[12]

A second attempt to deal with the recurrent cost problem was by the World Bank in its 1985 country economic memorandum. That study highlighted the main dimensions of the problem and urged a complete overhaul of the public investment program (PIP).[13] It suggested several actions designed to improve the productivity of public investment:

- revise the PIP in light of existing economic realities; initiate a series of three-year rolling plans as a substitute for the national development plan;
- focus on a core program of activities designed to rehabilitate existing capital, refurbish essential public services, and support the production of tradeable goods;
- develop plans for the rehabilitation of key sectors of the economy which would mobilize donor support for the "full nonsalary recurrent cost financing and foreign exchange requirements of a particular sector"; and
- ensure closer cooperation between the ministries of finance and economic planning to improve planning, screen investments, monitor implementation, and coordinate the recurrent and capital budgets.[14]

Lacking better alternatives for improving the performance of public investment, the ERP task force adopted the above suggestions. The World Bank included them as part of its conditions for its first structural adjustment loan (SAL-I). Those conditions included the requirement that analyses be undertaken of the recurrent cost implications of development projects in health, education, agriculture, and transport and communications had to be undertaken. These conditions were not met five years later and the significantly delayed disbursement of SAL-II (see chapter 19).

b. Implementation

Through the ERP and by agreeing to the World Bank's conditions, the government indicated its commitment to the above approach. Making it operational has been difficult. The World Bank, in effect, was requiring the government to abandon the idea of national planning

and to institutionalize a system of accounting and accountability into capital and recurrent budgeting that had not existed previously. Those changes struck at the core of the "spoils" system which had emerged in the planning ministry and the influence-peddling which was inherent in the budget process at the ministry of finance. Not surprisingly, none of the senior staff in the respective ministries was enthusiastic about the modifications. Resistance to the proposals was inevitable.

That resistance largely took the form of a "bureaucratic flop". Every one involved agreed that the changes were needed, some modifications in the choice of projects were made, studies were undertaken, and the appearance of forward motion was created. But, except where specific provisions have been vital for the continuation of donor support nothing substantive was achieved during the ERP.

To illustrate, public investment projects were classified into "A", "B", and "C" groups, with "A" group projects having the highest social returns and most immediacy. "C" group projects were the "wish list" such as the bridge-barrage or livestock range. The classifications were reviewed annually with the World Bank. Nonetheless, the parallel commitment to conduct a full-scale evaluation of each project together with their recurrent cost implications was ignored. Moreover, the government proceeded with some "C" list projects despite agreements with the donors to the contrary.[15]

The exercise to estimate the recurrent cost implications of development projects was never undertaken. In 1987, a consultant to the EFPA project computerized both the recurrent and development budgets. The intention was to link the budgets in ways that allowed an analysis of the recurrent cost implications of public investment over the course of the three-year rolling plan. However, once the computerization exercise was completed, the effort stalled. Senior members of both ministries were unwilling to move in directions which threatened their control over budget allocations. A computer link between the two budgets was particularly threatening in this regard. It would have substituted a "hard-wired" routine for a system of allocation which had become highly personalized and.[16] More important, however, linking the two budgets appeared to be a mechanism whereby the ministry of finance would gain influence over budget items which the ministry of economic planning considered its prerogative.

Other examples could be cited. The outcome has been the same. Few improvements have occurred in public investment appraisal, monitoring, financing, and implementation besides the changes which the donor community has insisted had to made. Indeed, in order to comply with the SAL-II conditions in 1991, the World Bank had to provide additional consultants to undertake sectoral reviews of public expenditure so that the government could fulfill a condition to which it agreed as part of SAL-I in 1986.

The recent recombination of the ministries of finance and economic planning could potentially remove these obstacles. Nonetheless, there is still considerable resistance to the idea of forward budgeting, and the government continues to be reluctant to devote its own resources to fund the recurrent costs of donor-supported projects.

4. Recurrent Costs and Public Investment in Practice

Notwithstanding the resistance to budget reform and reluctance to devote local resources to recurrent costs, some restructuring of the budget occurred under the ERP.

The IMF program introduced in 1986 had several specific requirements. These included a freeze on the wage bill, the full funding of debt service, a reduction in public investment, and increased allocations to "other charges". The wage freeze was part of the effort to reduce the size of the civil service. The requirement that debt service be fully funded was essential if The Gambia's international creditworthiness were to be repaired. The reduction in public investment was a recognition that The Gambia could not sustain additional external debt. Public investment would be confined to activities which had a high social return (a lower limit of 15% was set by the World Bank) and for which the donor community would provide concessionary finance. Finally, the increase in "other charges" explicitly recognized that a large part of the explanation for the low productivity in the public sector was the lack of complementary inputs. In this regard and despite the pressure to cut the budget deficit, the Fund was prepared to admit that additional government expenditure was essential in some key areas.[17]

Table 2 shows that some dramatic reallocations occurred within the budget under the IMF program. It compares the actual expenditure in 1984/85 (prior to the ERP) with the allocation in 1986/87, the first year of the IMF program.

In the area of public investment, however, the government's approach has not changed. Indeed, the condition that development expenditure be financed only on concessionary terms has made the government more highly dependent on the bilateral and multilateral donors. The budget allocation in 1986/87 of D159 million represented a decline in $ terms in government investment of 32%. Overall, the two budgets expressed in $ were of the same order of magnitude but the allocations for wages, salaries, and development decreased substantially. Debt service and allocations for subsidies increased sharply.[18]

Table 2: Government Expenditure 1984/85, 1985/86, and 1986/87

	1984/85	1985/86	1986/87
Wages and Salaries	58	63	65
Interest	29	33	76
Internal	18	16	27
External	11	22	49
Other Charges	64	68	95
Subsidies	--	16	91
Public Investment	109	91	153
Arrears	26	-35	-14
Government Expenditures	262	288	547
Revenue and Grants	180	272	485
Memorandum			
Budget Deficit after grants	57	51	76
Deficit as % of GDP	8.5	4.7	5.1

Source: Ministry of Finance and Economic Affairs, Macro Policy Analysis Unit, GDATA file.

The development budget (the top section of Table 1) is still dominated by expenditures for transport and communications. Agriculture continues to receive much less than its relative contribution to GDP and employment. Expenditures on health and education have increased primarily because of increased donor interest.

The Program for Sustained Development, introduced in 1990, did not change the basic focus. The PSD confirmed the principles to which the government is committed, but it offered no new insights. There was no coordinated effort in key areas such as trade, industry, or financial development has been developed.[19] The result was a patchwork of projects which depend heavily on the persuasiveness of the personalities who promote them. The Kairaba Beach Hotel is an example. Rushed through in order to provide accommodation to the visiting heads of state to an ECOWAS conference, it has now joined a long list of low productivity hotel investments that survive because of subsidies provided through the tax system.[20]

One area, where the government has devoted considerable effort is petroleum. The Gambia, it appears, like Senegal and Guinea Bissau, has petroleum deposits offshore. (There is the possibility of gas onshore as well.)

Development of the deposits, were they to occur, is decades away. In the meantime, considerable official effort is being devoted to encourage firms to become involved. Expectations have been raised, which, unfortunately, has diverted attention from dealing with more pressing current issues such as health and education.

This experience provides a very potent message about the possibility of fundamentally changing the allocation of recurrent and capital resources in The Gambia. Under pressure from the IMF, the government significantly altered the allocation of the recurrent budget. But in the absence of donor pressure, when the government had the opportunity to restructure its investment program under the PSD, it reverted to its former practice of developing a wish list of activities for donor consideration. The implication is that reform in the area of public expenditure is still a long way off.

5. Concluding Observations and Lessons Learned

The severity of the recurrent cost problem and the low productivity of public sector investment when the ERP was introduced required immediate action by the government to reorient the public investment program. The back-log of maintenance and rehabilitation placed serious strains on the whole budget (recurrent and development) during the ERP. That burden will persist for the foreseeable future.

Donor pressure and funding have played a major role in reordering expenditure priorities. Local initiatives to deal with the recurrent cost problem and rationalize public investment have not succeeded. Indeed, as the hiatus over public expenditure programming has shown, the government cannot deal with the recurrent cost problem in the absence of donor pressure.

In this respect, the donors are locked in. They have always shown far more concern about maintaining adequate levels of recurrent cost funding than government officials. The latter continue to believe (with good reason) that the donors will either fund the recurrent costs directly or do it indirectly by recapitalizing defunct development projects, and providing balance of payments support to pay off debts on projects that did not pay for themselves.

The donors will have difficulty extracting themselves from this bind. Government officials see little point in devoting their efforts and political capital to the task of raising resources that

one or more of the donors will eventually provide. Moreover, the government has experienced no political cost for allowing the roads to deteriorate, schools to operate without books and desks, and health clinics to run out of medicine.

The above discussion is a reminder of the limits of donor leverage. Reform as distinct from adjustment cannot be made a condition of donor support. As long as the donors continue to fill the funding gap, as well as pick up the pieces from run-down "development" projects, the government has no incentive to change.

Endnotes:

1. Heller (1974, 1979), for example, considered that a recurrent cost problem existed whenever the O&M components of capital projects were not funded at levels consistent with their designed output. Although this notion has been widely used (Gray and Martens 1983:103-104; CILSS 1982:17), it lacks an economic rationale. For a start, it ignores sunk costs. As economic circumstances change, capital owners may be perfectly rational in deciding to underfund the recurrent costs of particular projects. In The Gambia, for example, it would be a mistake for public resources to be devoted to maintaining the river wharves even though this project was finished only in the last several years. The only river boat which consistently used the wharves, the 'Lady Chilel', sank in 1985 and there is no prospect of a replacement.

2. That is, the recurrent cost problem derives from economic rather than an engineering or technical considerations. Such a problem exists whenever the reallocation of resources to O&M from other categories of public expenditure would produce a net addition to output and national welfare.

3. Public expenditure can be allocated efficiently but, because of limited resources, e.g., due to a collapse in national income or a decline in tax receipts, too few resources may be devoted to O&M to prevent the public sector capital stock from deteriorating.

4. The dual nature of the recurrent cost problem is regularly overlooked. Because of the way the problem has been traditionally defined, the recurrent cost literature (see reference in note 1) has focused almost exclusively on recurrent expenditure. In cases where recurrent costs are underfunded because of revenue shortfalls, it is as much a problem of inadequate recurrent revenue as inadequate recurrent expenditure (McPherson 1979).

5. The problem was so severe in the late 1970s in The Gambia and other Sahelian countries that the Club du Sahel and other donors supported a detailed study of the issue (McPherson 1979; Club du Sahel 1980; CILSS 1982).

6. The capital stock (middle of the table) was derived by the perpetual inventory approach using current investment (the top part of the table) deflated by the GDP deflator. I assumed a uniform rate of depreciation of 10%.

7. There were problems with the runway lights, the auxiliary generator, the communications equipment, and the fire-fighting equipment. All of this reflected a lack of maintenance.

8. At one point the government borrowed 100 tons of rice from Catholic Relief Services to provide the prisons with food.

9. For example, as part of its annual maintenance program, the GUC was due to service its main generator in February 1987. Announcements of service cuts had been made through the local media and preparations for the overhaul were in place. The engine was actually shut down. Upon his return from an overseas trip, the president enquired why there was no electricity. The generator was re-started. It was seen to be more important politically to create a favorable impression with the voters, who were due to vote in March, than to maintain the engine.

10. CILSS 1982; Gray and Martens 1983.

11. Respectively, GOTG 1981; 1984.

12. The review made no attempt to analyze the recurrent cost implications of the new investment (GOTG 1984:47).

13. World Bank 1985a:Chs.3,4, Annex I. This report has a detailed review of the PIP which the government had presented to the November 1984 donor's conference. According to the Bank staff, the PIP was too large, too unfocused, and had not addressed the recurrent cost implications of the proposed investment.

14. Because of the difficulties which the government had with the World Bank over the eventual release of the second tranche of the second SAL between 1990 and 1992, the original recommendation is worth repeating (World Bank 1985a:Ch.7,par.7.23c):

> Closer coordination between MEPID and the Ministry of Finance and Trade must be developed in order to ensure: (i) that a coherent macroeconomic framework guides public investment decisions; (ii) that investment screening involves thorough assessments of projects' direct and indirect recurrent cost implications; (iii) that project monitoring is substantially improved to provide a more accurate basis for annual investment budgeting; and (iv) that annual investment and recurrent budgeting are more closely coordinated.

The report added that "a merger of the Ministry of Finance and Trade with the Ministry of Economic Planning and Industrial Development should be considered as a means of achieving this coordination."

15. Two such projects, related to fish processing and livestock ranching, created major difficulties between the Bank and the government. Strong lobbies within the government existed for both projects. Despite its commitment not to proceed, government officials made preparations to implement the projects in ways designed to ensure that World Bank staff would not find out "until it was too late." World Bank officials, however, would not be coerced in this way. When they eventually found out, they insisted that the projects be cancelled. The president ultimately did as

the Bank required.

16. As noted in chapter 10, the budget reform process ran into difficulties when consultants suggested that detailed cost accounting be undertaken of standard budget items, e.g., vehicle expenses, building up-keep, travel, and office supplies.

17. A major departure from the usual IMF approach was its insistence that the government subsidize groundnuts in order to generate enough foreign exchange for the government to service its debt to the IMF (see chapter 5).

18. The subsidy was in fact indirect debt service since it was designed to ensure that the government obtained the foreign exchange to meet its external debt service obligations (see chapter 5).

19. For instance, one of the requirements of the SAL-I was the development of an export strategy. That effort foundered for several reasons. At the time, the ministry of finance was fully engaged in supporting the newly introduced exchange rate reform (see chapter 3) and in dealing with customs fraud (see chapter 12), and the World Bank was absorbed with the idea of introducing a duty draw-back scheme. The area of industrial policy has only just been addressed (Roemer 1992). Longer term proposals for financial development have been submerged by the requirements of keeping the existing financial reforms on track (see chapter 8).

20. The cost of this hotel and the degree to which established investment criteria were ignored became evident during a recent study of the tax system (Gray et al. 1992).

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External Debt Management

Clive S. Gray, Paul E. McNamara and Steven C. Radelet

1. Introduction

The Gambia's external debt began to mount rapidly in the late 1970s in conjunction with the implementation of the first five-year plan and the collapse of groundnut exports. Debt servicing difficulties became serious as The Gambia fell into arrears with several creditors in the early 1980s, and culminated when the government could not remain current with its obligations with the IMF in early 1985.

The country faced suspension of drawings on both Fund and World Bank loans as well as a loss of access to credit from other multilateral and bilateral institutions accustomed to following the Fund's lead. The World Bank classified The Gambia in 1984 among 12 SSA countries as "IDA-eligible countries with prolonged debt problems"; two years later, The Gambia still ranked among 22 "debt distressed" SSA countries in bank reporting.[1]

Starting in 1987, the level of debt began to stabilize. By 1990, The Gambia had fully extinguished its outstanding arrears. Both debt relative to GDP and debt service relative to exports declined sharply. Indeed, the World Bank reclassified The Gambia in 1987 and 1988 as one of 9 "moderately indebted low-income countries".[2]

The improvement in The Gambia's external debt situation in the late 1980s corresponded with the overall economic turnaround, and followed several changes in both debt <u>administration</u> and debt <u>management</u>. This chapter discusses the most important of these reforms.

Section 2 reviews the buildup in the Gambia's debt and external arrears. Section 3 examines the major change in debt administration: the introduction of a computerized debt monitoring and reporting system, which tracked debt levels, loan disbursements, debt service payments, and arrears. Section 4 analyses several debt management initiatives, including debt refinancing and rescheduling, policies to restrict the amount and terms of new borrowing by both the central government and parastatals, and a systematic elimination of outstanding debt service arrears. The final section offers some concluding observations.

2. Build-up in The Gambia's External Debt

At the end of 1975, The Gambia's public and publicly-guaranteed external debt amounted to 10% of GNP. However, external debt began to grow rapidly with the introduction of the first five-year plan, which included a large number of public sector investment projects financed by external loans. At the same time, public enterprise managers became aware of the availability of petro-dollars to finance their investments. Graph 1 shows the path of external

public borrowing during 1974-89. The bars give annual loan commitments by official and private creditors during 1975-88, while the line shows a three-year moving average of total commitments. By 1986, when disbursements had caught up with the surge in commitments during 1979-84, The Gambia's external debt had peaked at 229% of GNP.

The graph shows a substantial amount of commercial borrowing, from banks and suppliers, during the four-year period 1979-82. The principal destination of these funds was the construction of tourist hotels. Largely as a result of these loans, the grant element in total annual commitments to The Gambia, after averaging 71% during the four years 1975-78, dropped to 34% in 1979 and averaged 38% during the five years ending with 1983.[3]

By the end of 1979 The Gambia's international reserves had practically evaporated, dropping from the equivalent of three months' imports in December 1978 to less than a week's worth. By 1982 external arrears were attracting widespread concern. In 1983 the stock of arrears amounted to $32 million, or 15% of GDP; three years later they had reached $105 million, or 53% of GDP, and as noted above The Gambia had fallen into arrears with the IMF.

3. The Strategy to Improve Debt Administration

As this situation developed there was growing concern over the government's loss of control of its foreign borrowing. Government and donor attention focused on policies which would limit the growth in The Gambia's debt (see Section 4) and institutional changes in the MoF which would lay the basis for improved debt administration.

a. The MoF Loans Division

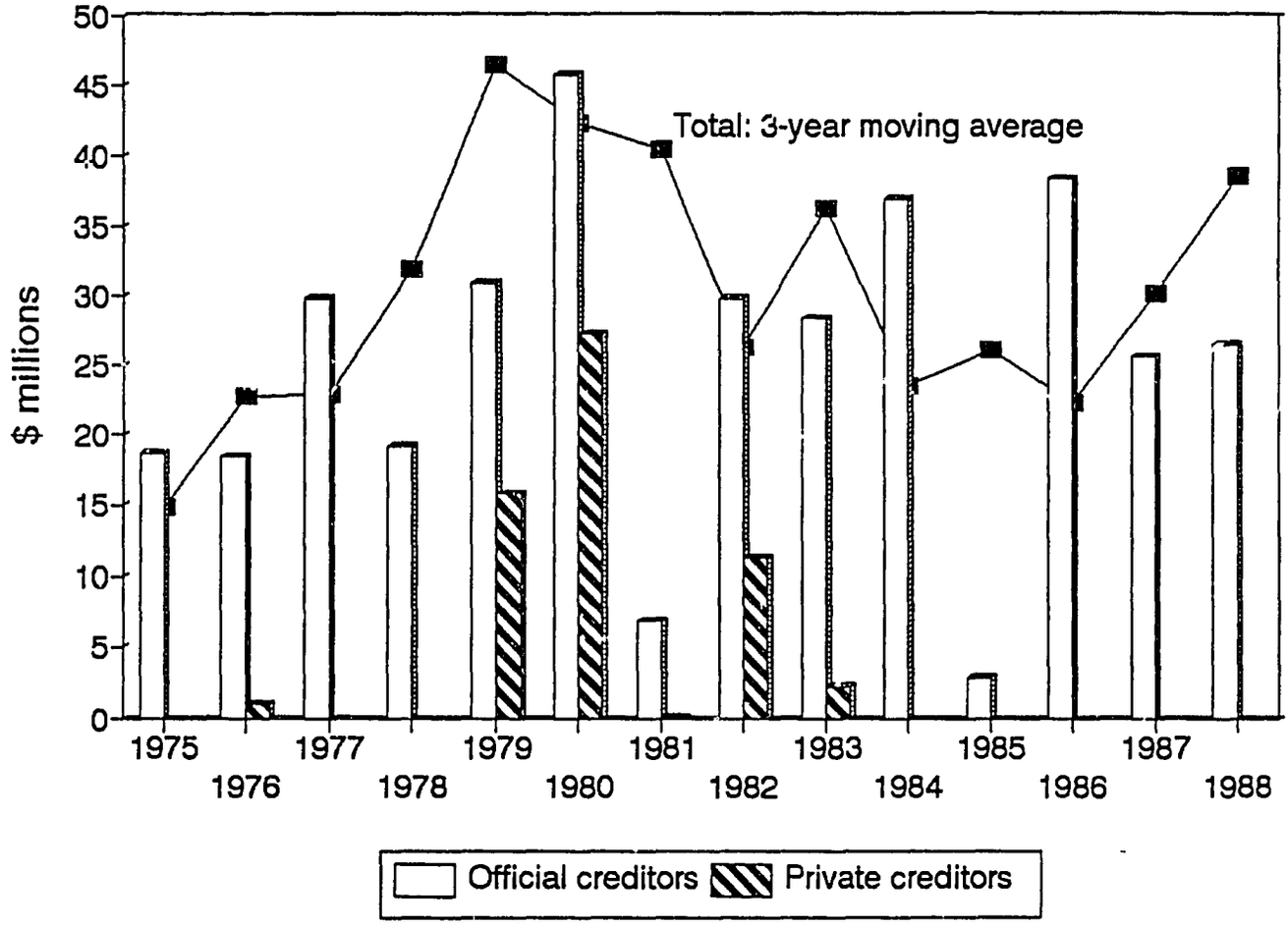
Ideally, a MoF external debt unit should carry out three functions (although under varying administrative arrangements some functions may be parceled out among different offices in the MoF):

- <u>administrative</u>: The debt unit should participate in loan negotiations, transmit disbursement requests, and process donor invoices for interest and principal payments.

- <u>statistical</u>: The unit should tabulate and summarize periodically all debt transactions and stock figures, including both disbursed and undisbursed balances.

- <u>analytical</u>: The unit should monitor and assess the build-up of external debt in light of the country's debt-servicing capacity, advise policy makers on the impacts of proposed loans, and design government's debt rescheduling strategy.

Graph 1: The Gambia - Loan Commitments 1974-89
Public & publicly guaranteed debt ($m.)



In 1985, the Loans Division of the MoF was implementing only the first function to any meaningful extent. It fully participated in most loan negotiations, and transmitted disbursement requests from throughout the government to the lending agency. It initiated requests to the Accountant General for payment of debt service obligations almost exclusively on the basis of telexes received from the donors, because it had little capacity to independently anticipate and verify amounts due.

On the statistical side, the unit had no systematic method by which to tabulate and summarize important debt data. Information on individual loans was kept in stacks of dusty files balanced on desk tops, window shelves, and along the floorboards of the Unit's cramped office. The ability to access information on a particular loan depended on the memory of the one person who knew the location of (almost) every loan file. The only summary statistics produced by the unit - the annual projections of debt service obligations - were grossly inaccurate.

With respect to the third function of a debt unit, there was no capacity in The Gambia's Loans Division for analysis of external debt.

b. Computerizing Debt Statistics

As a first step, the ministry decided to try to establish a simple routine for keeping track of external debt movements by personal computer to enhance the ability of the Loans Division to carry out its statistical and reporting function.

An earlier effort to launch such an exercise with World Bank assistance was stillborn. An old NCR computer lay gathering dust in a corner as a testimonial to this failed effort. The computer had never been fully operational, and was awaiting an NCR-trained technician from elsewhere in West Africa. The technician never showed up, as the foreign exchange necessary to pay for his services was not available.

Bearing in mind this earlier failure, considerable thought went into deciding what software to use in the new system. By 1985, a number of private consulting groups and multilateral organizations had designed integrated external debt packages which were being advertised as though the mere introduction of a given package would assure a developing country of sound debt management. In June 1985 the World Bank convened a Debt Systems Conference in Paris at which ten public and private organizations presented their systems.[4]

All the systems were based on database programs, and were protected against user modification. Most purported to facilitate accounting precision by attributing transactions to a given day and then automatically computing interest, commitment charges, and debt outstanding on a daily basis from that point. In this way their

promoters sought acceptance of the packages by central banks, treasuries, and other offices with responsibility for cash management.

Adoption of any of the systems would have meant initiating the MoF Loans Division staff into computerized reporting of debt via software whose algorithms they could not analyze and which therefore represented a 'black box' to them. This option might have made sense in earlier days of electronic data processing (EDP) when the only option represented mainframes or mini computers allowing for little interaction with the operator. However, given that The Gambia's debt reporting system was to function on user-friendly PCs, it seemed to make sense to look for a transparent software that the local staff could interpret and eventually modify as appropriate.

Moreover, the focus on accounting precision in these commercial packages ran the risk of unnecessary complication. Instead, priority was given to establishing a reporting system that would, in a timely manner, acquaint ministry management with correct orders of magnitude and alert them to impending payment obligations. The accounting function could be left to the Accountant-General's staff, working on an ex post basis with creditors' disbursement notices, invoices, payment receipts, and statements of outstanding balances.[5]

Ultimately it was decided to design a new system using the spreadsheet software Lotus 1-2-3. The system was named GEDRES (Gambia External Debt Reporting System). Its format was modelled closely on printouts issued at the time by the World Bank under its Debt Reporting System.

Direct data entry onto a spreadsheet which is then manipulated to analyze the data poses risks of data loss and distortion, and is not the approach recommended by EDP professionals. Moreover, customized database programs such as those offered by the vendors at the World Bank conference can perform the desired operations much more rapidly than a multipurpose commercial package such as Lotus 1-2-3. Staff of the World Bank's External Debt Division called attention to these issues when invited to comment on GEDRES' initial design in early 1986.

Ultimately it was believed that GEDRES' transparency offset these shortcomings. Moreover, it seemed that The Gambia's external debt portfolio - thought to be less than 100 loans in 1986 - was too small to warrant the investment in installing an outside package. As for processing speed, the opportunity cost of the additional seconds of computing time required for GEDRES to produce a report seemed negligible.

c. Installation of GEDRES

The Loans Division staff began to install The Gambia's loan portfolio on GEDRES in November, 1986. Initially, they relied on data from the ministry's file and printouts from the IBRD DRS system, which in some cases (such as IDA and African Development Bank debt) were based on data supplied by creditors. When large gaps in the data remained, the loans division requested updated information via telex from each creditor on the status of every loan.

For the junior Gambian staff members who assisted with the data entry, this was a painstaking exercise, more than for any other reason because they had no previous experience working on any type of keyboard, typewriter or computer. Indeed, one of the difficulties encountered was that few women had the basic training necessary to work in the office; and very few men had the desire to learn to type, as it was considered to be women's work. Unquestionably the additional burden of mastering simple Lotus commands delayed some stages of data entry beyond the time that a special debt package would have required. On the other hand no significant loss or distortion of data was observed, and the transparency of the Lotus-based system more than compensated for the delays.

By June 1987 the system was complete enough to produce summary statements of The Gambia's external debt position. Over the ensuing months, the system was refined and the quality of the data improved, so that summary statements could be produced on a quarterly basis. For the next three years, loans division staff entered new or corrected data regularly. GEDRES statements became the most complete and accurate information available on Gambian external debt. They were used extensively in discussions with the World Bank, IMF, and other donors, and became the source for The Gambia's annual submission for the IBRD debt reporting system.

d. Other Administrative Improvements: The Lost Payments Problem

GEDRES did not solve all of the debt administration problems. Even with the system, administrative weaknesses sometimes caused payments to be delayed or missed entirely.

The external loan payment process originated with the loans division preparing a request for payment and forwarding it to the Accountant General (AG) for approval. The AG had sole authority to request that the central bank make a payment on the government's behalf. Normally the entire process took less than two weeks; however, occasionally it could take several months. An investigation in mid-1987 revealed that the required paperwork for each payment had to pass through more than 35 pairs of hands (including line staff, typists, and messengers) in order for the

payment to be executed and recorded in everyone's books. Some payment requests were physically lost in desk drawers; others were not typed accurately and were not approved by the AG or central bank. Instead of following up immediately, the AG or central bank staff would often set the paperwork aside and wait for the loans division to rectify the situation; in turn, the loans division rarely knew about such problems until the creditor notified them that the payment was in arrears.

The MoF and the central bank developed two responses to this problem. First, the loans division prepared a master schedule based on GEDRES to monitor all payments in process. Second, the MoF and central bank established a debt monitoring committee that met on a bi-weekly basis to track payments. The committee reviewed the status of each scheduled payment on the master list to ensure that all payments were made on a timely basis. These responses helped reduce missing payments to a minimum, and The Gambia managed never to breach a reduction in the arrears target during the ERP.

e. GEDRES' Failure to Become a Tool of Policy Formulation

It would be inaccurate to claim that GEDRES became an integral part of the management information system on which the MoF leadership relied to formulate external borrowing policy. Throughout the period when GEDRES was producing the best data available on Gambian external debt, MoF management's reaction to its reports was passive. Successive ministers and permanent secretaries glanced at the statements but rarely took the initiative to ask for them or request interpretive memoranda.

Senior ministry staff appeared to be more interested in devoting the loans division staff to ensuring that new projects were funded and that loan proceeds were disbursed as quickly as possible. Senior staff demanded much less effort toward the monitoring and analysis of external debt and its implications for public finances. At the same time, as the economic crisis passed and The Gambia paid off its debt service arrears, there was less pressure from the donor community for accurate debt reporting (although some pressure continued from the World Bank). With turnover in expatriate support staff, and the internal and external pressure on the loans division to update the GEDRES files relaxed, the reports produced from late 1990 on were regarded as progressively less complete.[6]

4. Debt Management Initiatives

While the introduction of the GEDRES system helped The Gambia monitor its external debt more accurately (for a time), it had little direct impact on the size of the debt. Toward this end, beginning in 1985, the government took steps to begin to more actively manage its debt portfolio. Three government initiatives stand out in this regard:

- it introduced policies to manage the rate of expansion of external debt and the quality of projects financed by external debt;
- it rescheduled and refinanced overdue obligations with the Paris and London Clubs and other creditors, and
- it systematically reduced its debt service arrears between 1986 and 1990.

a. External Borrowing Policies

The government introduced four policy changes in 1985 as part of the ERP to begin to manage the rate of expansion and the quality of its external debt. First, public sector agencies (including the government) were no longer allowed to contract foreign debt on commercial terms. Although most commercial creditors and private suppliers had stopped lending to The Gambia as the economic crisis worsened in 1984 and 1985, several were willing to begin to lend again after 1987 as the economy recovered and foreign exchange reserves began to grow. The ban on commercial borrowing - which was an IMF performance criterion - forced government agencies to seek financing on soft terms from multilateral and bilateral agencies.

The second policy change was that public enterprises (except the central bank) were no longer allowed to contract debt directly from overseas creditors. All public-sector foreign debt had to be channelled through the government, and then on-lent to various state agencies. This change gave the government much more control over the investment projects and financing of the government parastatals.

The third new policy was the abolition of government guarantees on private sector projects. Much of the debt rescheduled by the Paris Club (see below) was originally borrowed by private entities in The Gambia, and guaranteed by the government. These amounts were lent by commercial creditors in OECD countries, with corresponding guarantees from their governments. When the Gambian borrower defaulted, both guarantees were called, and the obligation became a claim against the Gambian government. The IMF standby agreements which supported the ERP prohibited further government guarantees.

The importance of these changes was illustrated in 1987 when the Gambia Utilities Corporation (with the support of the ministry of works) reached preliminary agreement with an external company to purchase a new generator, financed with a supplier's credit. Although the need for new generation facilities was not disputed, the price of the generator was high, and the terms of the loan unfavorable. When the project was brought to cabinet for approval, the minister of finance reminded cabinet of its policy commitments, and that the proposed project threatened the IMF agreement. The proposal was rejected. A less expensive generator, with financing on concessional terms, was later installed. Similarly, the

government rejected loan guarantees on several private sector projects, most of which (including a large new tourist hotel) proceeded without the guarantee.

The fourth change focused on the quality of the projects financed by external debt. On the insistence of the World Bank, starting in 1985 only projects with an internal rate of return greater than 15% were included in the Public Investment Program. Although this criterion is not particularly stringent, it did force the government to evaluate more carefully its proposed projects and reject the poorest ones. This policy, like many others, was introduced ten years too late. Had The Gambia focused more on the quality of the debt it was incurring during the mid-1970s, much of the economic distress of the early 1980s could have been avoided. The extent to which the government continues to follow this policy, or takes other steps to enhance the quality of its public investment projects, will have a major impact on both economic growth and the burden of external debt in the 1990s.

b. Debt Rescheduling and Refinancing

The second of the government's debt management initiatives was to refinance and reschedule some of its overdue obligations. The Gambia's debt service arrears reached $105 million in 1986, and it was clear that it would be impossible for the government to quickly repay these obligations.[7] The IMF standby agreement in 1986 paved the way for the government to initiate negotiations with both the Paris Club (the group of OECD-member bilateral creditors) and the London Club (the group of commercial bank creditors).

A total of $17.7 million in obligations was rescheduled with members of the Paris Club. The Gambia was given five years grace (1987-92) with five years to repay (1992-97). Interest rates differed across creditor countries, but averaged 7.2%. $6.7 million (38%) of the amount rescheduled was for overdue obligations on a government-owned (and technically bankrupt) hotel. $6.1 million (34%) were originally private sector debts which either had been guaranteed by the government, or had become government obligations when sufficient foreign exchange was not available for the debtor to make scheduled payments.

$21 million was refinanced with the members of the London Club. $2 million was paid as a "goodwill" gesture during the negotiations; the agreement called for further payments of $1 million in each of the first three years (1988-90) and $4 million annually between 1991 and 1994. $18 million (86% of the total) was owed to Standard Chartered Bank (London); $10.6 million (50%) was due on the same government hotel which had debts rescheduled under the Paris Club. Thus, this single hotel accounted for $17.3 million (45%) of the amounts rescheduled with the Paris and London Clubs.

These agreements provided substantial debt relief during the period of the ERP by rescheduling payments from the mid- and late-1980s to the early 1990s. However, the agreements created a bulge in debt service due between 1992 and 1994. This potential problem was eased somewhat when the government of France canceled its debts with The Gambia. Preparations for the bulge in payments was made by a structured program to build up foreign exchange reserves between 1986 and 1992.

The government also rescheduled its arrears of $6 million with the Islamic Development Bank (IDB). These amounts were overdue on loans to the state-owned GUC and the National Trading Company (NTC). While the IDB did not provide a grace period for repaying the loans, it did not charge late interest on the overdue amounts. Moreover, only 35% of the arrears were repayable in foreign exchange. The remaining 65% was repaid in dalasis to finance the local cost of IDB-sponsored projects in The Gambia.

The central bank also reached an unofficial rescheduling agreement in 1988 on its overdue obligations of $20 million with the West African Clearing House (WACH). The agreement called for eight quarterly payments of $2.5 million between 1988 and 1990. The agreement was never formally signed because it gave more favorable terms (a higher interest rate and more rapid repayment) to the WACH than the central bank had given to the London Club. Instead of signing the WACH agreement and thereby violating the London Club accord, the central bank verbally agreed to repay the WACH by the terms of the unsigned agreement.

Thus, $65 million in debt - 30% of The Gambia's total foreign debt - was rescheduled between 1986 and 1988. These reschedulings rationalized the debt portfolio and provided immediate balance of payments relief during the ERP.

c. Repayment of Arrears

After the above reschedulings, the government had remaining arrears of approximately $41 million. These were repaid steadily between 1986 and 1990. The Gambia was obliged to make the repayments because of quarterly ceilings on outstanding arrears imposed by the IMF in its standby and E-SAF agreements. In the last few days of each quarter, the central bank would make a flurry of payments to the creditor which been most vocal in its requests, or with which the government had an upcoming important meeting, or from which the government wished to borrow additional funds.

The government was able to repay these arrears mainly because of the large foreign exchange inflows it received from the donor community to support the ERP (see chapter 16). While some aid flows were used to finance current consumption and investment (i.e., finance the current account deficit), large amounts were used to pay current and overdue debt service obligations and

replenish the government's foreign exchange reserves. In effect, a significant portion of aid flows (including the World Bank's Structural Adjustment Loans) were used to refinance current and overdue debt service payments.[8] Because of the concessional terms of the World Bank loans (forty years repayment including a ten years grace period with a .75% interest rate), this was a very favorable approach for The Gambia.

5. Concluding Observations

By the end of the ERP The Gambia's external debt situation had eased considerably. The ratio of external debt to GDP in 1990 had fallen to 146% (from 230% in 1986), and its arrears had been completely extinguished. Moreover, the terms of the debt had softened significantly. The grant element in new commitments undertaken between 1986 and 1990 averaged 74%, and no new loans had been contracted with private creditors.

Despite this turnaround, not all aspects of The Gambia's debt administration and management during the ERP were successful. The failure of senior policy makers to use GEDRES as a more permanent tool of economic management highlights the difficulties in introducing institutional changes in The Gambia. While the size and makeup of The Gambia's foreign debt will have a profound impact on economic growth and welfare over the next 50 years, few senior policy-makers seemed interested in debt analysis. The initial hope with GEDRES was that once MoF management saw the locally produced debt reports, it would take pride in them, find them useful and ensure that the system was maintained and improved. Thus far the hope has been in vain.

While the overall situation has improved, the amount of debt outstanding is still large. The major question regarding the Gambia's foreign debt is whether the progress achieved during the last several years can be maintained. The failure of senior policy makers to institutionalize GEDRES provides reason for concern. Several policies will have to be strengthened and sustained in order for The Gambia to avoid future debt servicing difficulties. First, debt financed development projects must be more carefully appraised than in the past. Second, the government should continue its moratoria on contracting commercial debt and providing government guarantees. Finally, the government should continue to implement policies which mobilize domestic savings to finance investment projects, primarily by further reducing the government budget deficit, but also by encouraging private savings.

Endnotes:

1. World Bank 1986; 1988.

2. World Bank 1989b; 1990.

3. Grant element of commitments from all creditors, according to various issues of IBRD World Debt Tables.

4. After the presentations were over a participant remarked from the floor that anyone who was not confused could not have been listening.

5. In making this judgement the staff had the advantage of a comment tabled by one of the software vendors at the June 1985 IBRD-sponsored conference. Noting the discrepancies between initial entries and creditor records of transaction dates and amounts, given exchange rate fluctuations, the passage of each payment through several agents, and uncertainty about the purpose of a drawing, the vendor, Interafricaine de Conseils d'Assistance (ICA), stated: "To achieve precise figures for dates and amounts on each transaction, ten times more work is required than for the simple capture of loan balances". It urged users of its system to begin with a statistical rather than accounting approach (World Bank 1985a).

6. The World Debt Tables' annual rating of data submitted to the Bank's External Debt Division by reporting countries lifted The Gambia from the lowest category (out of three) in 1986-87 to the highest in 1987-88, and then in two steps back to the bottom in 1990-91.

7. IMF 1986:42.

8. Thus, while the World Bank and other multilateral agencies never explicitly refinance or reschedule their existing loans, their loans serve as an important source of implicit refinancing.

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Rationalizing Domestic Debt

Catherine J. McAuliffe and Malcolm F. McPherson

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1. Introduction

From the mid-1970s onward, the government and the public enterprises (PEs) experienced difficulties generating the revenue needed to cover their expenditure. Borrowing, and hence public sector domestic debt, mounted rapidly. Over time that debt and other obligations were not being fully discharged. The resulting arrears, which are outstanding obligations that an enterprise has failed to discharge and for which there is no explicit repayment schedule began to increase rapidly as well. The arrears showed up in several areas. The government and PEs had undischarged interlocking obligations. Loan guarantees which the government had provided to the Gambia Commercial and Development Bank (GCDB) on behalf of private individuals and PEs were not honored. Those defaults, in turn, prevented the GCDB from repaying its loans to the central bank. Government payments to local contractors and suppliers were overdue. And, some government expenditure was being financed through suspense accounts at the central bank in effect, the central bank allowed the treasury to run up arrears as well.[1]

The rapid accumulation of domestic debt and arrears largely reflected the overall deterioration of the economy. The basic cause was a break-down in financial discipline throughout the public sector. Prior to the ERP, the government had made no effort to retire the arrears in a regular manner. It was only when the donor community made the elimination of arrears a specific performance criterion that systematic action was taken.

This chapter explores the nature of the arrears problem, how it arose, its economic effects, and how it has been rationalized. Section 2 places the problem in context. Section 3 examines the economic and financial consequences of domestic arrears. Section 4 reviews the attempts to deal with them. Section 5 discusses some lessons from the experience. Annex A reviews common options to deal with arrears.

2. Debt and Arrears

a. Background

As part of its normal operations, any government incurs debt, i.e., commits itself to a future stream of payments in return for current access to real resources. Short-term debt such as "ways and means" advances from the central bank cover temporary short-falls in government receipts; long term borrowing through bonds permit the government to support the expansion of public infrastructure or to invest in long-lived assets. Interest on the debt is a charge against the recurrent budget. Principal repayments may be met through a sinking fund or by additional borrowing.

When government expenditure grows at around the same rate as government revenue, the debt can be serviced without difficulty. However, when the growth of expenditure exceeds the growth of revenue over extended periods, debt service begins to absorb a larger share of the government budget.

There is a limit to the amount of debt which can be incurred without creating major macroeconomic distortions. Considerable attention has been devoted in the developed country literature to the notion of "crowding out" (i.e., the degree to which government borrowing excludes the private sector from access to finance). The ultimate limit, however, is whether savers will voluntarily release their surplus resources. Arrears go beyond that stage. Like the "forced savings" associated with inflationary finance, arrears result in the involuntary "post-hoc" release of resources to the government. They tend to emerge after the government has exhausted other forms of finance or is unwilling to continue financing its deficit by additional domestic bank borrowing.[2]

b. Domestic Debt and Arrears in The Gambia

The rapid rate at which the government expanded after the mid-1970s led to a sharp increase in the budget deficit. During the initial stages, the deficit was financed by foreign and domestic borrowing. In 1974/75 at the beginning of the first five-year plan, the government had a cash surplus with the local banking system equivalent to $1.7 million and external debt of $11.7 million (approximately 10% of GDP). By 1980/81, it owed the local banking system the equivalent of $25.7 million and its external creditors $77.6 million. These debts could not be serviced even then. Arrears, both domestically and abroad, had emerged.

Table 1 gives an overview of the government budget and the role of arrears in financing that deficit.[3] From 1975/76 the budget deficit increased as expenditures rose more rapidly than revenues.[4] Budget arrears began to accumulate in 1983/84. They declined in 1985/86 as the ERP policies began to take effect.

Like the government, expenditure by the PEs increased dramatically from the mid-1970s onward. Due to mismanagement, poor planning, malfeasance, and pricing policies which did not allow costs to be covered, a large number of activities undertaken by the PEs were unproductive. Their losses mounted and arrears emerged (see chapter 7). Many enterprises failed to pay their obligations to government such as taxes, levies, and debt service. Some would not surrender revenue collected on behalf of the government.

The interlocking arrears between government and the PEs were large. Tables 2 and 3 give details for 1985 and 1986. During 1985, the government failed to make D6.3 million in current payments to the PEs, equivalent to 3.8% of current government expenditure and 11.5%

Table 1: Arrears and the Government Budget, 1983/4 to 1987/8

	1983/4	1984/5	1985/6	1986/7	1987/8	1988/9
Government Receipts	153	180	275	480	495	576
Government Expend.	211	262	258	542	607	516
Change in Arrears	21	26	-35	-14	-5	-25
Deficit (inc. grants)	-37	-57	-18	-76	-118	34
Estimated GDP (D mn)	599	673	859	1078	1251	1490
Arrears as % of GDP	3.5	13.9	-4.1	-1.3	-0.4	-1.7

Source: Ministry of Finance and Economic Affairs GDATA file.

of total financing requirement for the year. In 1986, the government accumulated an additional D9.6 million in current payment arrears (3.9% of its current expenditure and 13.1% of its total financing requirement). At the same time, PEs accumulated D7.9 million in arrears during 1985 and an additional D7 million during 1986. On a net basis, the arrears were D1.5 million in favor of the government in 1985 and D2.6 million in favor of the PEs in 1986.

Government arrears emerged indirectly as well through the government's provision of bank guarantees and the governments' ownership of PEs. Government guarantees to domestic banks were minimal in the mid-1970s, but they reached major proportions by the early 1980s. Some projects failed and the borrowers could not repay. In the majority of cases, the borrowers (both individuals and PEs) refused to pay. The volume of outstanding unserviced debt on government-guaranteed loans increased to the point that it threatened the viability of the whole financial system.[5] In 1987, the GCDB, The Gambia's largest commercial bank, held government guarantees on loans amounting to D72.6 million, equivalent to 34.8% of its asset base.[6] One reason why the GCDB was insolvent was that the government had not honored its guarantees.[7]

The government's ownership of the PEs increased its contingent liabilities. For example, in 1977/78 the PEs had operating profits of D18.8 million; by 1982/83, their operating losses were D47.7 million.[8] Those losses were funded by bank borrowing. By mid-1986, the PEs owed the local banks (primarily GCDB and the central bank) D217 million (approximately $32 million). A considerable proportion of this debt (e.g., GCU's debt to the GCDB) was overdue. Thus, indirectly through its equity, the government was in arrears.

Table 2: Arrears Between Parastatals and the Government (Thousand Dalasis) as at December 31st, 1985

	Owed to Govt.		Owed to PEs		Net Position	
Pub Ent	Current	Arrears	Current	Arrears	Current	Arrears
GNIC	1,101		36		1,065	
GPMB	257			12,797	257	-12,797
GUC	4,128	64,640	4,008	10,970	120	53,670
GPA	14	10,046	1,844	5,859	-1,830	4,187
GAMTEL			191		-191	
GPTC	311			142	311	-142
GCU		34,006				34,006
NTC			53		-53	
LMB	101				101	
SSHFC						
Atl Hot	1,431		104		1,327	
Sen Hot	541		94		447	
Gam A/W			4		-4	
TOTAL	7,884	108,692	6,335	29,769	1,549	78,922

Notes:
(1) A negative entry is a net debit (-).
(2) "Current" means payment arrears in current financial year.
(3) "Arrears" are payments due from previous financial years.

Acronyms:

GNIC Gambia National Insurance Corporation
GPA Gambia Posts Authority
GAMTEL Gambia Telecommunication Company
NTC National Trading Corporation
SSHFC Social Security and Housing Finance Corporation
Atl Hot Atlantic Hotel
Sen Hot Senegambia Hotel
Gam A/W Gambia Airways

Table 3: Arrears Between Parastatals and the Government (Thousand Dalasis) as at December 31st, 1986

	Owed to Govt.		Owed to PEs		Net Position	
Pub Ent	Current	Arrears	Current	Arrears	Current	Arrears
GNIC	286		34		252	
GPMB	257			12,797	257	-12,797
GUC	4,971	67,780	5,217	10,200	-244	57,580
GPA	14	9,613	2,188	6,344	-2,173	3,270
GAMTEL			800		-800	
GPTC	486		276	142	210	-142
GCU		34,006				34,006
NTC			60		-60	
LMB	44		56		-12	
SSHFC	37				37	
Atl Hot	155		330		-175	
Sen Hot	726		83		642	
Gam A/W			570		-570	
TOTAL	6,977	111,399	9,613	29,484	-2.636	81,914

Notes:
(1) A negative entry is a net debit (-).
(2) "Current" means payment arrears in current financial year.
(3) "Arrears" are payments due from previous financial years.

There were other arrears as well, most of which became evident only as the effort to straighten out the public sector accounts unfolded. Examples include the rent owed by the government to the central bank which had been outstanding since the late 1970s,[9] charges incurred by the central bank for the operation and eventual liquidation of the defunct Agricultural Development Bank; and unserviced advances to government from the central bank to finance emergency generating equipment for the Gambia Utilities Corporation (GUC) and to pay for the extension of Yundum airport. In addition to its other debts noted in Tables 2 and 3 above, the GUC was accumulating arrears to government on its fuel purchases. Finally, the Gambia Cooperatives Union (GCU) had not recapitalized several revolving funds which had been set up by the donors (see chapter 9).

c. Why Did the Government Allow Arrears to Emerge?

The government could have prevented arrears simply by requiring the central bank to finance all of its domestic expenditure in full and on time.[10] Why wasn't this done? There were two reasons. First, because the government was unable to control its deficit the only way it could meet the credit targets agreed with the IMF was to allow arrears to accumulate.[11] That response has been common in developing countries.[12] Second, for strategic and/or political reasons the government was not prepared to pay PEs which were not discharging their obligations. That situation generated a "game" in which the PEs would not pay the government because the government would not pay them, and vice versa.

Despite being a large net creditor to the PEs (Tables 2 and 3), the government was in a weak position to force payment. Financial monitoring in any meaningful sense did not exist. Estimates of current revenue and expenditure were often several months out of date and the government's debt records were incomplete (see chapter 14). Lacking reliable data, the government was never able to insist that the PEs should pay since the amounts could always be challenged.[13] Furthermore, the PEs could make the valid argument that their arrears arose because the government had failed to pay for services they had provided or had interfered in their output and/or pricing decisions.

With the continuing deterioration of the economy, the government and PEs alike found it more convenient (and less costly) to ignore many of their mutual obligations.

3. Consequences of Arrears

At one level mutual arrears between the PEs and the government are economically and financially innocuous. On a consolidated basis the net worth of the public sector is unaffected by such indebtedness. What financial harm is caused if the government owes

itself resources that, through one of its agents, it does not repay? Vertically integrated private enterprises often have large amounts of interlocking debt with no apparent adverse effects.[14]

On a strict accounting basis it is difficult to make the case that mutually offsetting arrears between the government and the PEs have any relevance. It is also difficult to argue that arrears matter if they occur on an irregular basis. All enterprises, public and private, experience disruptions in their cash flow that may cause some payments to be delayed.

Arrears become economically and financially important, however, when they persist or are used strategically.[15] One is evidence that established financial and accounting practices have broken down. The other reflects an explicit change of behavior by the debtor who uses the arrears to gain access to additional interest free resources. When the government is in arrears, the resources are not only interest free but are equivalent to a tax.

The distortions created in both instances have real resource costs.[16] Arrears on current payments, for example, imply that the creditor has made an unanticipated loan to the debtor. Debt service arrears imply that the debtor has unilaterally rescheduled the debt with the creditor involuntarily providing the debt relief. If the creditor already has equity in a debtor's operations (as in the case of the government and PEs) the grants or debt relief are equivalent to the unintentional provision of additional equity.[17] Enterprises which benefit most from that equity are typically those with the largest losses - a clearly non-optimal way to use any nation's resources.

The involuntary transfers distort the allocation of resources in the economy by giving organizations access to resources that, on efficiency grounds, they would normally be denied. By accumulating arrears, debtors are able to maintain levels of output which are unjustified by their debt servicing capacity. Creditors, on the other hand, experience an unanticipated loss of resources. Unless they also accumulate arrears (as occurred in The Gambia) or they raise additional resources, their output will fall. Economic efficiency declines because the economically inefficient individuals and firms increase their share of overall economic activity. Efficient enterprises face the further disadvantage of experiencing greater difficulty gaining access to resources. Moreover, the resources they get come at a higher cost.

The accumulation of arrears erodes the asset base of creditors and reduces their profitability, thereby undermining their potential for further expansion. For the government, the non-receipt of current payments increases the budget deficit which, if not offset by expenditure cuts, non-bank borrowing, tax receipts or grants, leads to an increase in government arrears or further net borrowing from the banking system. Any increase in the volume of bank credit

will have potentially adverse effects on domestic prices, the balance of payments, and/or the exchange rate.

The accumulation of arrears distorts the structure of assets and liabilities of the organizations involved. The debtor has a liability which it does not service; the creditor has an asset which is not being serviced. In situations where the assets of both organizations are regularly revalued, for example, through a stock market, the consequent decline in asset quality would be reflected in the market value of the firm. If the debt were traded in secondary markets, its rate of discount would increase.

Where regular market revaluations of the assets and corresponding debt do not occur, or where accounting procedures do not reflect the erosion of asset quality, third parties can unwittingly incur arrears. That situation can be aggravated by political pressure on the third party (often a state-owned bank) to lend to organizations whose asset positions are distorted. In The Gambia, the financial viability of the GCDB was undermined, in part, because of the loans it made at the behest of government. Many of these loans were to non-viable organizations.

Persistent arrears, as in The Gambia, can also have an impact on costs and prices in the economy. For creditors, arrears imply forced financing. In anticipation of further accumulation of arrears, suppliers adjust prices to allow for payment delays. Creditors will often require higher interest rates on future loans especially if they anticipate that the loans will not be repaid as scheduled.

4. Resolving the Arrears Situation

Several measures incorporated in the ERP helped alleviate the arrears problem. Fiscal discipline began to be reimposed with expenditure controls and revenue-enhancing actions which reduced the budget deficit. The parastatal reform program began to improve financial management in the PEs with beneficial effects on their profitability (see chapter 7). The performance contracts between the government and the PEs included specific agreements to eliminate the arrears. A "managed fund" of non-performing government-guaranteed debt was created as a means of removing those debts from the GCDB's portfolio. The special deposit account for the local counterpart of external debt service payments was brought up to date and properly administered. An attempt was also made to unravel the more than 250 "suspense accounts" on the central bank's books.

Conditions imposed by the IMF and World Bank initiated the process of eliminating the arrears. Under the 1986/87 stand-by arrangement, the government agreed to prevent further arrears. The National Investment Board was required to monitor the arrears and

report on them on a quarterly basis. The World Bank was instrumental in establishing the managed fund[18] and having the performance contract system implemented (see chapter 7).

Because of their magnitude and complexity, a structured program for eliminating the arrears was needed. Some debts could be resolved by agreeing to offset mutual obligations. Other debts required a combination of write-offs, write-downs, refinancing, rescheduling, and/or the conversion of the debt to equity (see Annex A). The real resource costs of these measures were greatly eased by the government's access to counterpart funds. Those funds, which had been sterilized under the IMF program so as to avoid pressure on the foreign exchange market, allowed the government to "straighten out the books" without incurring major charges against the current or future budgets.

a. Government/PE Interlocking Arrears

Under the performance contracts, which sought to formalize the responsibilities and obligations of both the government and PEs, the financial operations of the PEs were to be disentangled from those of the government and procedures established for keeping them separate. Eliminating interlocking arrears was an important first step in that process.

The government also made a commitment to make its taxes and subsidies explicit through the budget and to force the parastatals to operate on commercial terms. Those changes were intended to disclose fully the financial inter-relationships between the government and the PEs and to ensure that the financial costs borne by the public sector approximated the social opportunity cost of the resources being used.

The first three performance contracts were negotiated with the GPMB, the GPA, and the GUC (see chapter 7). As shown in Tables 2 and 3, the GUC was the government's largest debtor owing roughly D70 million. The government in turn owed GUC around D14 million. The government's largest creditor was the GPMB which had an outstanding claim of D12.8 million.

The GPA was financially sound. Eliminating its arrears was straightforward. After offsetting mutual debts, the net balance owed to the government was paid off by the GPA in quarterly installments during 1986/87. For the GUC, the task was more complicated due to the long-term and chronic nature of the arrears (some of which had been outstanding since 1978) and their value (D72.8 million at end-1986). As already noted, the GUC disputed some of the debt. Eventually an agreement was reached to: (i) cancel mutual debts of D14.6 million; (ii) convert D26 million of debt into equity; and (iii) reschedule the remaining D29.9 million over 20 years, with a ten-year grace period, at 9% interest. That interest rate was half the prevailing bank rate at the time.[19]

With respect to the GPMB, government officials recognized that the Board's accumulated marketing losses were a major obstacle in restoring its financial viability. The agreement with GPMB was expanded beyond the objective of eliminating interlocking arrears. The government used its creditor position with the central bank at the time to retire GPMB's pre-1986/87 debts of D95.8 million. For its part, the GPMB wrote-off the D12.8 million which was owed by government.

b. Government-Guaranteed Debt

The managed fund of government-guaranteed debt was established in January 1987. Such a fund was suggested by the World Bank financial sector review mission in 1983 as a means of dealing with the precarious financial state of the GCDB.[20]

The managed fund consisted of 24 loans. Some of the loans, e.g. several to the GCU, had not been serviced at all. Others, such as the loan to a local manufacturer, were being serviced irregularly. The idea of establishing the managed fund was to ensure that the government honored its guarantees. The government borrowed from the central bank at the prevailing bank rate to establish the fund. The interest bill on the debt alone for 1987/88 was D14 million.[21]

Creating the managed fund demonstrated that the government would honor its guarantees. It also strengthened the finances of the GCDB and provided a mechanism for attempting to collect the outstanding debt. An inter-ministerial committee was given the responsibility of pursuing the debtors to work out mutually acceptable repayment schedules.[22] The collection of outstanding debt has been slow. Up to June 1989, only D2.4 million (3.2% of the original amount) had been collected.[23]

c. Other Arrears

The government paid off its debt to the central bank on account of GUC (the emergency loans for generators) and the extensions to Yundum airport in 1988. The central bank's expenses incurred in the operation and liquidation of the Agriculture Development Bank (ADB) were paid in 1989. The back rent owed by the government was discharged in 1990. And, the net amount of the miscellaneous items outstanding in central bank suspense accounts were dealt with in 1990.

Despite several agreements to pay, the GUC did not discharge the arrears on its fuel payments. By June 1989, they were in excess of D20 million. They increased by a further D20 million during 1989/90. After repeatedly failing in its commitment to reduce the arrears, the IMF made their reduction an explicit performance criterion.

Revaluation losses incurred by the central bank on the government's behalf had exceeded D450 million by December, 1987. Since no formal arrangement had been made for these losses, the central bank, in effect, had allowed another government account to move into arrears. The amounts were eventually covered in 1988 when the Parliament approved the issue of non-interest bearing, non redeemable notes to the central bank.

d. Overview

The most economically debilitating aspects of the arrears situation in The Gambia were brought under control during the ERP. Difficulties still arise from time to time. For instance, the hotels are not always prompt in turning over revenue collected for government. That situation changed following the enactment of the National Sales Tax Act (1988) and the introduction of improved collection procedures. Because of pressure on its travel budget, the government often delays payments to Gambia Airways as a means of deflecting donor attention from this item of expenditure. And, arrears on customs duties, particularly for items taken on "direct delivery" reached levels which prompted an official enquiry (see chapter 12).[24]

Although arrears have been reduced in The Gambia, they have not been eliminated. Additional arrears continue to be incurred when it has been expedient.

5. Concluding Observations

Persistent public sector arrears are an index of financial indiscipline. The practical requirement for avoiding arrears is simple: the government and its agencies have to ensure that their expenditures and revenues grow at rates which allow their obligations to be discharged on time and in full.

The emergence of payment difficulties and especially payment arrears should be a signal to debtors that the current financial situation is unsustainable and that adjustments have to be made. One approach would be some mutually acceptable agreement between the creditor(s) and debtor(s) to resolve the arrears in a systematic fashion. Another approach would be a decision by debtors to avoid using arrears as a means of gaining access to additional resources.

In the Gambia, sloppy accounting, lack of accountability, financial irresponsibility, and strategic considerations allowed the domestic arrears situation to get out of hand. Under the ERP, progress was in unravelling the interlocking arrears between the government and the PEs and developing procedures to prevent them from recurring. Essential to this effort was the oversight provided by donor agencies.

Although the exercise has been time-consuming and difficult, its real (resource) costs have been minimized by the availability of counterpart funds. No major sacrifice in terms of the absorption of domestic savings has been required. That approach was convenient; whether it was wise is unclear. The apparent low cost of dealing with the arrears may tempt the government, especially when it is no longer under strict donor surveillance, to allow arrears to accumulate at some future date. Because the government and PEs alike, continue to use arrears strategically, that is a real possibility.

Annex A: Debt Write-offs and other Options

Many options to reduce the debt burden on an organization are available. They include: write-offs, write-downs, refinancing, rescheduling, and the conversion of the debt to equity. The relative merits of these options differ.

A debt write-off grants the debtor a waiver of both the principal and accumulated interest. The creditor absorbs the loss. Write-offs have several disadvantages. They:

- involve no penalty for debtors who fail to honor the original loan agreement;
- improve the debtor's balance sheet by (involuntarily) adding resources which could not be obtained through the debtor's productive efforts;
- provide no assurance that the conditions which created the arrears have been dealt with;
- adversely affect managerial incentives by creating the expectation that the creditor (particularly if it is the government) will forgive other debts when they become a burden; and
- have high opportunity costs for the creditor since it diverts resources from more productive investments.

An additional complication for the government is that many of the debts involved were loans from external creditors which were on-lent. Write-offs do not extinguish the original obligations.

In general, debt write-offs are counter-productive; they should be used only as a last resort, and (possibly) only to rescue an important PE from liquidation. They should never be provided without explicit action to remove the original cause of the arrears. A debt write-off, however, would be justified if the debt had been incurred at the government's direction or the government imposed controls which directly prevented the PE from covering its costs.

A debt write-down involves the partial forgiveness of the debt. The creditor may agree to such an action as a means of preventing the debtor from failing. By foregoing a part of the debt, the creditor may be able to recover the remainder.

Refinancing is typically expensive for the creditor. He/she provides additional resources in exchange for the debtor's commitment to be more diligent about repayments in the future. For governments which are cutting their expenditure, refinancing is unattractive.

Debt rescheduling is common. It involves having the creditor accept the principle that responsible asset management requires

flexibility. Debt rescheduling entails some losses to the creditor because the terms of the original debt will not be met. But it is often the least cost method of ensuring that the debtor will repay. From the debtor's perspective, rescheduling provides an additional period of relief from principal payments which can be used to improve financial performance.

The conversion of debt to equity favors the debtor by effectively formalizing the situation which began with the build-up of arrears. For most creditors, including the government, the option is undesirable because it means taking a larger stake in an organization that has already demonstrated its unreliability. Another unattractive feature is that it increases the government's equity in PEs at a time when most are attempting to divest. The advantage of debt conversions are that they reduce the financial burden on the organization.

Endnotes:

1. A reviewer of this essay argued that the government could not be in arrears to the central bank because interest automatically accrued on the amounts outstanding. Whether interest is accrued by the creditor is immaterial. The distinguishing feature of an arrear is that no agreement exists between the creditor and debtor to delay the payment in the first place. As such, it is a zero interest loan. Government arrears also involve an element of taxation.

2. Unwillingness rather than inability is the main explanation. Few governments anywhere deny themselves the opportunity to borrow domestically. (Indonesia is a notable exception.) Because the government has access to central bank finance domestic arrears, in principle, need never arise.

3. The magnitude of the arrears problem is difficult to determine due to problems of identification and quantification. In practice, considerable discretion exists in classifying overdue payments as arrears. Yet, even if a consistent classification had been used, measurement would remain a problem. Many data in The Gambia were reported only after long delays. Moreover, because the government and PEs had attempted to disguise the magnitude of their arrears, data on them were being withheld on purpose.

4. Government expenditure in 1974/75 at the start of the first five-year plan was 19% of GDP; a decade later in 1984/85, it was 38% of GDP. Corresponding data for revenue were 16% and 27%, respectively.

5. Wing 1983; World Bank 1985b.

6. Since GCDB held 55% of all commercial bank assets, government guaranteed loans accounted for 19% of all bank assets.

7. In 1986, GCDB's capital and reserves were -D23.9 million (Ladd 1989:Ex.6).

8. World Bank 1985c:Table 7.1.

9. As of mid-1990, the amount owing was D12.5 million. It had been accruing since 1979.

10. Through "ways and means" advances or treasury bills <u>not</u> suspense accounts.

11. This was a one-off operation. Once the IMF staff discovered the arrears, they began to monitor the budget deficit on a commitment basis. The government then disguised its arrears by making greater use of suspense accounts at the central bank. The IMF discovered this ploy when unexplained movements in "other items

(net)" in the monetary survey occurred. As a result, the IMF focused on movements in "domestic assets" in the monetary survey. Then the government induced some contractors to withhold requests for payment in return for accommodation at the GCDB. That stratagem was discovered as well. Another outlet through which the government diverted pressure from its budget, namely by having the public enterprises fund particular items, was cut off with the introduction of performance contracts.

12. Diamond and Schiller 1987.

13. That tactic was regularly used by the GUC and the GCU to deflect attention from their debts. For instance, GUC staff continually referred to a 1983 Cabinet decision which they maintained had converted their debt to equity (it had not). They also argued that one of their earlier debts had been paid (it had not). To dispense with the disputes, the ministry of finance accepted the GUC's own data.

14. Indeed, as students of transfer pricing among transnational corporations point out, interlocking debt works to the advantage of vertically integrated firms. One local manufacturing company in The Gambia has made a loss every year since it began operations in 1976. Its major shareholder, which is also its main foreign supplier, has given no indication that it will be closing the firm.

15. The distinction is a fine one. All managers understand that once they have established a reputation for honoring their debts in full and on time their creditors will show forbearance if some payments are inadvertently delayed. Their reputation collapses, however, once they begin to let payments slide on a regular basis. In the first case the arrears are entirely unintentional; in the second, they are intentional. Only the second case has lasting economic and financial consequences.

16. Fye and McPherson 1987.

17. Recent financial literature has focused on the issue of whether the distinction between equity and debt has broken down (Kopcke and Rosengren 1989). For instance, questions have arisen about whether holders of junk-bonds provided loans which would be regularly serviced, or equity upon which dividends may eventually be paid. This views the situation only from the debtor's perspective. The asset holder had a different expectation when he/she purchased the debt. Had they wanted equity, they could have more productively used other markets. Asset-holders have different expectations regarding the security, liquidity, and yield of debt instruments relative to equity claims.

18. World Bank 1985b.

19. The total in the agreement is D70.5 million whereas the amount in Table 3 is D72.8 million. The former were taken from GUC's records; the latter from the government's (see note 13 above).

20. World Bank 1985b.

21. Having established the principle that the government would honor its guarantees (as well as demonstrating to the politicians that guarantees often involve substantial costs) the government cut its interest bill in 1988/89 by using its accumulated cash balances to retire the central bank loan.

22. One of the first issues raised when the committee began its work was to locate the relevant documents. None of the loans had been properly documented. The mortgages were either missing or had been prematurely released. The loan guarantees had been completely ad hoc with no accountability whatsoever.

23. Up to June 1991, D9.5 million had been collected. The committee responsible for collecting the debts classified them into recoverable and non-recoverable. The latter accounted for D58.6 million (or 79% of the original balance). This amount has effectively been written off.

24. Reports by the Auditor General and an external investigation of customs by two experts (cf. Dunlop and Livings 1992) indicate that the practice continues.

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Donor Support for the ERP

Steven C. Radelet

1. Introduction

The donor community initially became actively involved in The Gambia in the early 1970s. Many donors strongly supported the government's first five-year plan, providing loans and grants to finance the rapid expansion of the public sector under that plan. But in the late 1970s and early 1980s, the donors failed to pay adequate attention to the Gambian economy's dynamically unsustainable growth path. It was not until 1983, when debt service arrears began to mount rapidly and the donors were no longer being repaid, that they became concerned about the direction of the economy. Over the next two years, the donors gradually withdrew their financial support. The cessation of aid was a key factor in forcing the government to formulate the ERP in 1985.

Once the government began to implement the reforms, the donors provided generous financial and technical support. Between 1986 and 1989, donors and commercial banks provided financing that averaged the equivalent of 43% of GDP. About one-third of these resources were used to finance investment and consumption. The other two-thirds were used to build up foreign exchange reserves and pay current and overdue debt service. The conditions attached to these aid flows sometimes hindered, but usually facilitated implementation of the ERP.

This chapter examines the role of the donor community in the ERP. The next section recounts donor support for the public sector expansion of the late 1970s, and the withdrawal of that support in the early 1980s. Section 3 examines the role of the International Monetary Fund (IMF), the World Bank, and other donors in the formulation and implementation of the ERP. Section 4 analyzes the economic and political impact of the financial support provided by the donors. The final section offers some concluding observations.

2. Donor Support Before the Economic Recovery Program

a. Donor Financing for the Public Sector Expansion, 1975-83.

Donor agencies began to provide substantial support for The Gambia in the early 1970s. In 1975, the government introduced its first five-year plan, which marked the beginning of a rapid expansion of the public sector (see chapter 2). The government dramatically increased spending on development projects, civil service wages (mainly through an increase in the number of employees), and subsidies on rice, fertilizer, electricity, and transportation. Public investment increased by 700% in six years, and many new parastatals were established. By 1983, the public sector accounted for two-thirds of all modern sector employment.

This expansion was funded primarily by the donor community. The current account deficit rose from 2% to 21% of GDP, almost all of which was financed with grants and loans from multilateral and bilateral agencies. Between 1975 and 1985, foreign aid averaged $80 per capita, one of the highest levels in Africa, and 67% higher than that received by neighboring Senegal.[1] Aid flows were particularly high ($120 per capita) in 1980 and 1981 because of drought and the attempted coup. About half of these flows (equivalent to 10% of GDP) were grants. The other half were loans, and The Gambia's indebtedness to multilateral and bilateral creditors increased from $13 million in 1975 to $139 million in 1985.

On the plus side, this level of foreign assistance shielded The Gambia from the impact of the increases in world oil prices and the decline in world groundnut prices. The Gambia's external terms of trade fell 60% between 1976-81. The terms of trade improved between 1981-85, but there had been a 20% decline over the ten year period. Nevertheless, the increase in grant financing was more than <u>twice</u> as large as the foreign exchange losses from the deterioration in the terms of trade[2].

Shielding of The Gambia from the severe terms of trade shocks through foreign aid was a double-edged sword. While donor support financed investment which otherwise would not have taken place, the government's choice of investment projects, and its management of those projects, was poor at best. Donor oversight was no better, and financing continued for many projects whose net contribution to national income was low.

Moreover, aid flows permitted The Gambia to avoid the policy adjustments which should have been made in response to the terms of trade shocks. Donor financing allowed the unsustainable situation to continue for several years after some observers noted that fundamental policy change was needed.[3] Indeed, as late as 1981, the World Bank concluded that "the economic policies of the government, including producer prices, have been quite satisfactory ... (and) the poor growth record of the 1970s was almost exclusively attributable to unfavorable weather conditions".[4] When the donors finally began to press the government to reform in 1983, the magnitude of the changes necessary was much larger, and The Gambia's external debts had become unserviceable.

b. The Withdrawal of Donor Support, 1983-85

The donors began to rethink their support when The Gambia fell into arrears on its debt service obligations. Loan disbursements fell sharply in 1983, and the donors began to call for reforms. The reduction in disbursements was followed by a reduction in foreign exchange reserves, forcing The Gambia to negotiate a stand-by program with the IMF. The agreement, which was signed in February, 1984, required a 25% devaluation and established limits on domestic

credit expansion and government expenditure. But these changes were too little and too late to halt the economic deterioration.

Despite the poor state of the economy and the withdrawal of donor support, most government officials had not yet recognized the need for fundamental change. The government convened a donor conference in November 1984 to seek financing for a four-year D1.15 billion investment program (170% of 1984/85 GDP). The proposed program did not include any policy changes aimed at addressing the basic macroeconomic imbalances. Instead of engendering financial support, the conference ended with calls for major cuts in and a complete reorientation of the program.[5]

By January, 1985, the government was in arrears to the IMF, and it had breached the targets on government expenditure in the standby program. The Fund canceled the program, and its Board began the process of declaring The Gambia ineligible for further drawings. Without a Fund program, the government was unable to attract additional financial support. It made special appeals for balance of payments assistance to the governments of the United Kingdom, the United States, and Saudi Arabia. Each appeal was denied. The World Bank also made it clear that it would not provide assistance until The Gambia reached a new agreement with the IMF. The government's normal channels of foreign support had completely evaporated. Meanwhile, foreign exchange reserves had all but disappeared, and shortages had emerged for rice, fuel, and other imported products.

3. Donor Support for the Economic Recovery Program

The donors played an important part in the formation of the ERP. The catalyst for action was the World Bank's Country Economic Memorandum of May, 1985. It bluntly described the nature and origins of The Gambia's economic crisis and recommended that the government introduce a wide range of organizational and policy reforms as part of a stabilization and structural adjustment program. Shortly after the World Bank released the report, Minister of Finance Sisay assembled a task force of mainly Gambian economists to develop a program for economic reform (see chapter 2).

Soon after Cabinet approved the ERP, the government outlined the program and the country's resource requirements to a Special Donor's Conference in London. Initial reaction was favorable. The donors generally agreed that the ERP was comprehensive and bold. Nevertheless, they were not willing to pledge support based only on the government's intention to initiate reform.

Once the government floated the dalasi, raised interest rates, and retrenched nearly 3,000 government employees in early 1986, donors began to appreciate the depth of the government's commitment.

Initial support consisted of fuel grants from the governments of the United Kingdom and the Netherlands. However, more substantial support form the donor community was impossible until The Gambia reached agreement with the IMF for a new standby loan. The major obstacle to such an agreement was the government's arrears to the Fund.

a. The IMF Programs

After the IMF gave a favorable reaction to the ERP in late 1985, senior government officials had hoped that a Fund mission in February 1986 would begin negotiations for a standby program. Unfortunately, this mission did not share the government's view that the policies already adopted under the ERP had produced results which justified a program. Specifically, the mission highlighted what it saw as two major problems. First, it claimed that the float of the dalasi had failed (three weeks after it was introduced) because liquidity had been allowed to increase sharply. Second, it found what it thought were large (unprogramed) increases in development spending.

The government did not share the Fund's negative perspective on the progress of the ERP. Indeed, as subsequent events showed, the IMF mission's initial reactions to the float were premature. The increase in liquidity had resulted from an abnormally early peak in groundnut purchases which had been accentuated by the sharp increase in the groundnut price (from D640 per tonne to D1100 per tonne); and the increased development spending identified by the IMF was an arithmetical error the mission staff made in converting Norwegian kroner to SDRs. Despite the merits of the government's case, the damage had been done: the departure of the IMF mission delayed any prospect of additional donor support.

However, both the UK High Commissioner and the US Ambassador in Banjul took steps to limit the damage done by the Fund's assessment. Both made a special effort to convey The Gambia's point of view to their superiors, giving a much more positive perspective than the Fund team had given. Partly as a result of their support, the Fund team was sent back to Banjul in May 1986 to structure a standby program.

The IMF team found that the economy had stabilized and an a solid recovery was underway. At this point, negotiations began for a standby program. The main obstacle was The Gambia's arrears to the Fund which, by then were SDR 11 million. Because of the IMF Board's decision to review these arrears on August 2nd and declare The Gambia ineligible if they were not settled, the problem had become pressing.

The government approached Standard Chartered Bank (London) for bridging finance to pay the Fund. After being assured by the IMF and World Bank that The Gambia would obtain assistance once the

arrears were settled, Standard Chartered loaned the government SDR 15.3 million. SDR 11.1 million was used to pay the IMF arrears, SDR 1.9 million was designated to pay obligations that would fall due to the Fund from August to October 1986, and SDR 2.3 million to repay the government's debt service arrears to Standard Chartered with respect to a the Atlantic Hotel. With the arrears to the Fund cleared, the government was able to sign an agreement for SDR 18 million[6] on August 1 - one day before the IMF Board was scheduled to meet to declare The Gambia ineligible.

The conditions imposed by the Fund under the standby program were consistent with the broad thrust of the ERP. As a result, the government's discussions with the Fund focused on the details and timing of policy implementation rather than the general direction of policy. The conditions imposed limits on bank credit to the government, bank credit to the GPMB, the stock of net domestic assets, the stock of outstanding external arrears, and the amount of short-term external debt owed by the GPMB and the central bank. They also included a moratorium on publicly guaranteed non-concessional foreign borrowing in the 1-12 year maturity range.

The one area of disagreement was the producer price of groundnuts. As discussed in chapter 5, the Fund advocated a 50% subsidy for groundnut producers, requiring a transfer to the GPMB equivalent to 8% of GDP. Minister Sisay, while supporting the idea of a subsidy, wanted it to be much smaller (17%). The Fund's position prevailed.

The agreement with the Fund was critical, for it paved the way for additional financing from other donors (see below). It also imposed strong discipline on fiscal and monetary policies, ensuring a package of stabilization measures to support the float of the dalasi. The government met all of the performance criteria under the program (with one exception for technical reasons). Based on the success of the standby and accompanying three-year Structural Adjustment Facility (SAF), the government negotiated a three-year Extended Structural Adjustment Facility (E-SAF) worth SDR 21 million in September 1988. Over the entire five year period when these programs were in place, the government met essentially all of the performance targets, and regularly received positive reviews by Fund missions. When the E-SAF ended in 1991, the Fund no longer saw a need for a program, and The Gambia became the first African country to "graduate" from an IMF E-SAF program.

b. The World Bank Structural Adjustment Program

The World Bank has been closely associated with the ERP from its inception. A World Bank staff member participated in the ERP task force. Numerous World Bank missions indicated their support for the government's adjustment efforts. Nevertheless, the World Bank required that the government sign an IMF standby agreement before it would agree to a Structural Adjustment Credit (SAC). During 1985/86, there was close consultation between the Fund, the Bank,

and the government, and discussions toward a SAC proceeded concurrently (and often simultaneously) with discussions with the Fund.

The World Bank's focus differed from that of the IMF. The IMF emphasized exchange rate and monetary and fiscal policies while the Bank concentrated on agricultural policy, civil service reform, parastatal reform, and the reorientation of the Public Investment Program. Because these reforms were already included in the ERP, discussions with the Bank, like those with the IMF, related to policy implementation rather than the overall direction of policy.

Final discussions on the SAC were held during the last week of July 1986, at the same time as negotiations with the IMF. The total amount made available under the SAC was SDR 29 million. Of this amount, SDR 14 million came from the World Bank, SDR 10 million from the African Development Bank, £3 million from the government of the UK (as a grant), and 12 million Saudi Riyals from the government of Saudi Arabia.

The conditions of the SAC reflected the Bank's emphasis on structural adjustment. They focused on reorganizing and streamlining the civil service, improving the quality of the Public Investment Program, reforming the agricultural credit system, eliminating the groundnut subsidy over three years, implementing performance contracts with several parastatals, and establishing a managed fund of D72 million of loans which were made under government guarantees by the GCDB.

Measuring the government's progress under the World Bank loans proved to be more difficult than under the Fund programs. Almost all of the IMF targets were established as numerical limits, making performance relatively easy to measure. The World Bank conditions, on the other hand, were much more subjective in nature. They included phrases such as "adopting programs" and "reviewing the feasibility of" new systems, the successful completion of which was subject to some debate.

The World Bank agreed that the government met all of the conditions for the first SAC. However, negotiations on the second SAC were delayed, first because of the reorganization of the World Bank, and later because of disagreements on the timetable to introduce reforms in the GCDB. The second SAC was finally signed in June, 1989, and provided $41 million from the World Bank, the ADB (African Development Bank), and the governments of the Netherlands, Switzerland, and Norway. The second tranche of SAC II was originally scheduled for early 1991, but was delayed by the Bank's dissatisfaction over progress in groundnut marketing reform, the reorganization of the GCDB, and preparation of the public expenditure program.

Whereas the government's agreement with the IMF was important for the signal it provided to the international community, the World Bank programs have been critical because of the vast amount of resources involved. With these large funds The Gambia was able to repay all of its arrears and replenish its foreign exchange reserves (see below).

c. Other Donors

Three other sources of foreign aid were important to the success of the ERP: fuel grants from the UK and the Netherlands, STABEX grants from the European Community, and US rice and AEPRP (African Economic Policy Reform Program) grants.[7]

The Dutch government donated a total of 20 million guilders worth of fuel between 1984 and 1987. The UK government donated £10.5 million worth of fuel between 1986 and 1989. These fuel grants were important for two reasons. First, they were the only substantial support provided by the donors before the IMF agreement, and they played an important role in stabilizing the dalasi after the float. Second, they helped quickly end the shortage of fuel which had emerged in 1985, easing potential political opposition to the reform program.

The European Community provided a total of SDR 13 million in STABEX (European Community's scheme to stabilize export earnings) grants to The Gambia over the period 1986-88. Although these grants were not explicitly connected with the ERP, they helped build up foreign exchange reserves and finance the groundnut subsidy. These relatively large grants, which arrived at crucial times and without any explicit conditionality attached, have been particularly effective in promoting the goals of the ERP.

Between 1983 and 1985, the U.S. government helped cover drought-related shortfalls in domestic food production with emergency food shipments. After 1985, in an effort to regularize this support in ways that would encourage the expansion of agricultural production through price supports, USAID agreed to supply The Gambia with 24,000 tons of rice (worth $4 million) over three years. The rice, which was used as a buffer stock to insure against shortages in the local market, was sold by tender to private traders for resale in The Gambia. The dalasi proceeds were used to finance the groundnut subsidy.

The rice grants differed from both the fuel grants and the STABEX funds in that they were highly conditional. The conditions required the government to liberalize the rice and fertilizer markets, reform the indirect tax system, and introduce a series of measures aimed at the eventual privatization of the GPMB.

The rice grants had three effects. They eased the pressure on the balance of payments by reducing the amount of foreign exchange

required to import rice, they provided counterpart funds to help finance the groundnut subsidy, and they enabled the government to enhance national food security through a buffer stock.

The US government also provided $6 million over three years as an AEPRP grant. These grants were used to discharge specified external debt payments. The funds were conditional on the adoption of financial sector reforms, of which most were aimed at improving the performance of the GCDB.

Another important source of balance of payments support during the ERP was debt relief. Refinancing and rescheduling agreements worth $65 million were reached with the Paris Club, the London Club, the Islamic Development Bank, and the West African Clearing House. The debts with the French government were later forgiven. (see chapter 14).

Finally, a number of donors provided the government with technical assistance during the ERP. The UK government provided assistance in the accountant general's office, the central bank, and the president's office; the US government provided assistance to the ministry of finance; the IMF provided two advisors to the central bank; and the UN provided assistance in the ministries of finance and economic planning. This assistance eased the administrative and technical burden on the government during the adjustment program, freeing the time for senior officials to concentrate more fully on policy formulation and implementation.

4. The Economic and Political Effects of Foreign Aid

Taken together, the donors and commercial banks provided The Gambia with resources equivalent to SDR 38 million in 1985/86 (24% of GDP), SDR 84 million in 1986/87 (74% of GDP), SDR 59 million in 1987/88 (43% of GDP), and SDR 51 million (34% of GDP) in 1988/89. Slightly more than half of these amounts were grants, and most of the rest were concessional loans.

By almost any measure, this was a huge amount of foreign financing. About one-third of the aid was used to finance current consumption and investment, allowing a small real increase in both during the adjustment period. The increase in investment was important in helping to provide a foundation for long-term growth, while the small increase in consumption helped ease political opposition to the reforms. In addition, the aid flows were critical in stabilizing the exchange rate and reducing the extent of the depreciation necessary during the ERP.

The bulk of the aid was used to pay current debt service obligations, repay arrears, and increase the government's depleted foreign reserves. The government completely paid off SDR 89 million in arrears between 1986 and 1990, and increased its foreign

exchange reserves from the equivalent of one week of imports to the equivalent of 12 weeks of imports in just 2 years. In effect, the aid flows rationalized the implicit borrowing The Gambia had undertaken in the early 1980s when it failed to service its debts. The donors not only financed current economic activities, they effectively released the aid flows they had been withholding in previous years.

The largest single source of this financing was the World Bank. The SAC was primarily a refinancing package. The government was able to borrow new money on soft terms (40 year repayment period with a 10 year grace period and .75% interest) to repay all of its overdue loans.

Chapter 17 includes an analysis of the impact of these aid flows on The Gambia's economic growth after the introduction of the ERP. That analysis indicates that about one-third of the renewed growth can be traced to the impact of the foreign aid flows.

The aid flows also helped ease potential political resistance to the reform program (see chapter 18). The timely fuel grants from the UK and Dutch governments, received just before the government floated the dalasi, helped to ease the fuel shortages and to reduce the immediate pressures on the exchange rate. That reduced the price increases faced by urban consumers for imported goods and hence the erosion of real income. The resumption of aid-financed investment projects created a large number of urban jobs, particularly in construction and small manufacturing, both of which grew rapidly during the ERP.

5. Concluding Observations

The Gambia provides an example of both the failure and the success of foreign aid. The massive amount of resources provided by the donors to The Gambia in the late 1970s failed to place the economy on a path of sustained economic growth. While much of the blame for this failure can be attributed to the government itself, and with the series of external shocks the country experienced, the donors share some responsibility. Project selection often did not realistically reflect the economic and physical constraints in The Gambia and project oversight was lax.

On the other hand, donor support for the ERP was highly effective. To begin with, by refusing to continue financing The Gambia's imbalances, the donors forced the government to consider fundamental reforms. Donor support also provided the necessary leverage to ensure the implementation of important reforms. The conditions attached to the aid were broadly consistent with policies which the government had already agreed to under the ERP. For the most part, the donors showed an appropriate combination of flexibility and resolve with respect to the conditions: flexibility

when it was clear that the government had breached a condition for good reasons (as with several IMF targets), and resolve when the government tried to renege on important commitments (such as the reform of the GCDB).

Moreover, the donor agencies tended to maintain a consistent approach. The staff of the major donors - the IMF, the World Bank, and the governments of the UK and the US - communicated regularly. Despite different focus, they were careful not to work at cross-purposes.

Finally, the donors provided resources in amounts large enough to stabilize the economy and spur economic growth. Donor resources helped The Gambia rationalize its debts and replenish its reserves without an undue compression of investment and consumption.

The future direction of the donor community's aid programs will have an important bearing on economic progress in The Gambia during and after the PSD. While it served the Fund's purposes to have an African country "graduate" from its E-SAF program, it is not yet clear whether the government, on its own, will be able to maintain the fiscal and monetary discipline initiated under the ERP. With the government's arrears cleared, a comfortable stock of foreign reserves, and the economy growing, there is much less need for donor support than there was in 1985. However, as donor programs are phased out those in the government who favor reform could be ushered aside. An unanswered question is whether the reform effort will continue as donor influence wanes.

Endnotes:

1. World Bank 1985a.

2. Radelet 1990:49.

3. McPherson 1979.

4. World Bank 1981:i.

5. World Bank 1985c.

6. The agreement included a three-year Structural Adjustment Facility worth SDR 8 million, a 13-month standby arrangement for SDR 5.1 million, and SDR 4.7 million from the Compensatory Financing Facility.

7. The EC STABEX program provides grants to African countries that suffer shortfalls in export earnings due to drought or sharp declines in world prices for their export products. The STABEX grants that The Gambia received were due to export shortfalls in 1981, 1985, and 1986.

17

Accounting for Growth under the ERP: Results from a CGE model

Steven C. Radelet

1. Introduction

How much did the policy reforms of the ERP actually contribute to The Gambia's economic turnaround? The reforms were comprehensive, affecting almost every area of economic activity. But did they stimulate the renewed growth? Or, can it all be explained by the massive inflow of foreign financing and the end of the drought?

This chapter, analyzes these questions using a computable general equilibrium (CGE) model. With the model, I compare economic conditions after the reforms with a simulation of what the economy would have been like in the absence of the adjustment measures and other concurrent changes. I then disaggregate the effects of individual policy reforms, the policy package, foreign aid, and increased rainfall.

This analysis suggests that all three factors - but especially the policy reforms and foreign aid - contributed to The Gambia's economic recovery. It further indicates that none of these three influences, on its own, would have been sufficient to produce an increase in per capita incomes. The results highlight the importance of the combination of comprehensive reforms and adequate foreign financing for successful economic adjustment. They also illuminate the different effects that individual policy reforms and aid flows can have on economic growth and income distribution.

2. A Computable General Equilibrium Model of the Gambian Economy

In this section, I describe the most important characteristics of the Gambian CGE model.[1] Output in each of the eight sectors in the model is determined by a constant returns scale Cobb-Douglas production function. There are three labor categories: rural, urban formal, and urban informal. Informal and rural labor are fully employed with flexible wages; formal sector wages are fixed nominally (with some resulting unemployment), reflecting the influence of government employment and wage policies. Intertemporal rural-urban migration is specified by a modified Harris-Todaro formulation.[2] Capital is assumed to be sector-specific and in fixed supply in the short run. Real government expenditure is fixed exogenously.

The model includes both an official and a parallel market exchange rate. All imports, exports (except groundnuts), and private capital transactions use the parallel rate. Groundnut exports from the state marketing board and public capital flows use the official rate. The parallel exchange rate acts as the numeraire in the model, with the official rate defined as 67% of the parallel rate in the base year (1985).

The model is closed by assuming that the level of foreign savings is exogenous, with the level of investment determined by total

savings. This choice of closure rule reflects the fact that foreign savings in The Gambia are predominately aid flows, which are primarily determined by administrative decisions rather than economic signals. This specification also facilitates an analysis of the effects of changing the level of foreign aid.

3. Model simulations

The model simulations which follow show the impacts of seven major changes that affected the Gambian economy between 1985 and 1988:

- the float of the dalasi;
- the reduction in government recurrent expenditure;
- the increase in the groundnut subsidy;
- the increase in private capital inflows;
- the reduction in the import tariff on reexport products;
- the increase in rainfall; and
- changes in foreign aid.

Experiments 1 - 5 represent the major policy changes of the ERP that contributed to the economic turnaround. Experiments 6 and 7 represent exogenous non-policy changes that affected economic performance during the period. Analysis of the various combinations facilitates an evaluation of the impacts of individual policies, the synergistic effects of the package of reforms, and the interactions between the reforms and the other changes.

I measure the impact of these changes against a simulation of the hypothetical condition of the economy in the absence of reform. This methodology captures the full impact of the reforms by incorporating the deterioration of the economy which would have occurred without the ERP.

a. Simulation of 1988 Without the ERP (the Base Scenario)

To evaluate the full impact of the changes, I first simulated the hypothetical condition of the economy in their absence. In The Gambia, had there been no reforms, the amount of capital inflow would have fallen sharply: both donors and commercial banks had already stopped disbursing funds, and the government's foreign exchange reserves were exhausted. Thus, I simulate the no-reform scenario by reducing the level of public foreign capital inflow from $28 million in 1985 to $10 million in each year thereafter.[3] The results of this simulation are shown in Table 1.

The sharp fall in foreign savings, and thus investment, leads to reductions in output in both industry and construction. Labor shifts out of these activities and into groundnut processing, reexports, and, to a lesser degree, services - all tradables sectors. As a result, exports increase and imports decline, reducing the current account deficit as necessitated by the fall in foreign financing. Agricultural output declines, but groundnut

Table 1: Model Simulation Results: Aggregate Change in Output (1985-88) From a Reduction in Public Foreign Savings to $10 million (No Reform Scenario)

Sector	Percentage Change in Aggregate Output, 1985-88
Agriculture	-3.2%
Groundnut Production	5.9%
Groundnut Processing	5.3%
Industry	-12.1%
Construction	-49.5%
Public Services	0.[illegible]%
Services	2.[illegible]%
Reexports	7.2%
GDP	-2.7%

production increases as rural labor moves into relatively more profitable groundnut cultivation. Overall, GDP falls 2.7% over the three years. Real wages in both the rural and informal sectors fall, while the number of employees in the fixed-wage formal sector is reduced sharply.

These results indicate the extent to which the Gambian economy would have deteriorated in the absence of the ERP and the accompanying aid flows. Indeed, the deterioration had already begun in 1985: shortages were widespread, much urban labor was idle, public investment projects had been interrupted, and a general malaise was evident (see chapter 2).

b. Update to 1988 with All Changes

The seven changes together increase total output 14.9% over the no-reform baseline, as shown in column 1 of Table 2. Construction and industry benefit from the sharp expansion in investment, financed through increased savings of each type: household (as incomes rise), government (as the recurrent budget moves from a deficit to a surplus), and foreign (as both aid and private capital flows increase). Higher levels of rainfall and the float of the dalasi stimulate production in both agriculture and groundnuts; groundnut production is further encouraged by the subsidy (see chapter 5). Both rural and informal real wages increase sharply, and formal sector employment expands as the real formal wage falls, indicating that the changes had a net positive impact on poorer Gambians, thereby improving the distribution of income.

Table 2: Model Simulation Results:
Change in Output from Policy Reforms, Increased Rainfall, and Foreign Services

(percentage change from without reform scenario)

Sector	All Changes (1)	Float (2)	Government Expenditure (3)	Groundnut Subsidy (4)	Private Capital Flows (5)	Import Tariff in Reexport Sector (6)	Entire Policy Package (7)	Increased Rainfall (8)	Foreign Savings (9)
Agriculture	16.6%	2.2%	0.0%	-1.5%	1.5%	-0.6%	1.4%	8.6%	4.1%
Groundnut Production	23.5%	7.[illegible]%	1.3%	9.0%	-2.4%	0.5%	16.1%	6.1%	-0.4%
Groundnut Processing	28.2%	10.4%	1.5%	11.5%	-2.4%	0.5%	21.5%	4.1%	0.0%
Industry	32.8%	15.0%	0.9%	-2.4%	4.5%	-3.2%	14.1%	1.1%	12.8%
Construction	176.7%	88.5%	21.5%	-10.3%	17.0%	-24.9%	87.3%	0.0%	69.0%	
Public Services	-7.8%	0.0%	-7.8%	0.0%	0.0%	0.0%	-7.8%	0.0%	0.0%
Services	3.6%	-0.2%	0.2%	-2.7%	0.5%	-0.4%	-3.8%	2.3%	3.0%
Reexports	-3.7%	-16.6%	0.7%	-1.5%	-1.8%	15.0%	-2.3%	1.3%	-2.0%
TOTAL	14.9%	2.8%	0.8%	-1.0%	1.3%	1.6%	5.1%	2.9%	4.7%

The higher incomes and increased aggregate demand (relative to the no-ERP scenario) cause prices to rise in each sector, leading to a loss of international competitiveness. Thus, despite the float, exports are smaller than in the no-ERP scenario (although they are still larger than before the reforms) and imports rise. These changes lead to a larger current account deficit as expected with larger foreign borrowing.

The next set of experiments simulate each of these seven changes individually.

c. The Policy Changes

The Float. The first individual policy experiment simulates the effects of the float of the dalasi. I do this by merging the official and parallel rates so that all transactions take place at the same, higher rate. This specification highlights the expenditure switching effects of the change in relative prices from the depreciation of the official rate. The results are shown in column 2 of Table 2. The immediate impacts are to raise the dalasi value of groundnut export receipts, foreign aid flows, and debt service payments by 50%. Domestic prices of imported goods also rise (even though importers still use the same exchange rate) because customs officials value imports for tariff purposes at the new exchange rate.

The combination of higher government revenue and the increased dalasi value of public foreign borrowing increases the supply of investable funds. Output grows sharply in industry and construction, driving up wages and prices in each sector. Higher domestic prices lead to a loss of international competitiveness, and production shifts away from exports toward the domestic market. Exports fall except in groundnut processing, the one sector that had previously used the official rate. Although import prices rise slightly, import volumes increase because of the higher level of domestic demand. On the whole, production grows 2.8%.

The stimulus to groundnut production and the investment sectors leads to increases in both rural and informal real wages. The real formal sector wage falls, so formal sector employment expands, reducing urban unemployment.

In this simulation, the float does not lead to an improvement in the current account deficit because of the closure rule, whereby foreign borrowing is fixed and investment adjusts. In effect, I have assumed that the government would have used the increase in domestic savings to expand investment rather than reduce foreign borrowing, which would have been the case had donors been willing to continue providing finance. In a separate experiment with the alternative closure rule of fixed investment and endogenous foreign borrowing, groundnut exports expand and imports fall, leading to a $10 million decrease in the current account deficit. With the fall

in imports, and lacking the stimulus to the investment sectors, output falls 1.4%. Real rural wages rise, although not as much as in the first simulation, and real informal wages fall slightly. Thus, the impact of the float depends critically on the corresponding level of foreign financing.

Reduction in Government Expenditure. Government spending in the three years following the introduction of the ERP was 15%, 19%, and 8% lower (in real terms) than in 1985. A large component of this reduction was the government's retrenchment of nearly 3,000 employees in 1986. The results of a model simulation which reduces aggregate government spending and adjusts the input-output coefficients in the public service sector to reflect the relative decline in the wage bill are shown in column 3 of Table 2.

The reduction in recurrent spending is offset by an increase in investment as government savings increases. In effect, government spending shifts from current consumption to public investment. The net impact on output is minimal. Industry and services lose from the fall in government spending but gain (along with construction) from the growth in investment. Formal sector employment falls as the real wage increases, and real rural and informal wages change little.

With the alternative closure rule of fixed investment (noted above), the reduction in government spending leads to a smaller account deficit. Output falls in public services as well as in the three sectors toward which government spending is directed (industry, construction, and services), and overall production declines 1.3%. More formal sector workers lose their jobs than in the above scenario, and rural and informal sector wages fall sharply. Thus, when the reduction in government spending is used to reduce the current account deficit instead of expand investment, output declines, with much of the burden falling on the poor.

The Groundnut Subsidy. In one of the most remarkable changes of the ERP, the government raised the farmgate price of groundnuts in 1986/87 from D1100 to D1800/tonne, 50% above the export parity price of approximately D1200/tonne (see chapter 5). The government lowered the price to D1500/tonne in 1987/88, and completely eliminated the subsidy in 1988/89.

I simulate the subsidy in the model by changing the export tax on groundnuts from 12% in 1984/85 and 1985/86 to -50% and -25% in 1986/87 and 1987/88, respectively. The results are shown in column 4 of Table 2. Output in the groundnut production and groundnut processing sectors grows 9% and 11.5%, respectively, over the three years. The subsidy leads to a sharp increase in the government budget deficit, reducing total savings and investment. Overall output declines by 1%.

An important effect of the groundnut subsidy was to provide financial relief to rural dwellers, whose incomes had shrunk markedly during the late 1970s and early 1980s. The increase in real rural wages (7%) and agricultural and groundnut production indicate significant growth in real rural incomes. Although the subsidy was transitory, it was an important means of supporting the poorest Gambians during the period of adjustment.

In this experiment, the assumption of fixed foreign borrowing implies that the subsidy was funded by a reduction in public investment, leading to a fall in output in the capital goods sectors. The alternative, perhaps more realistic, assumption is that the subsidy was financed by foreign aid, with investment remaining constant. With this assumption, output in the construction and industrial sectors does not decline as sharply, and there is a slight increase in total output. Real rural wages increase even more sharply, and informal wages rise as well. Formal sector employment increases as the real wage falls. Thus, under the fixed investment assumption, the positive impact of the groundnut subsidy on poorer Gambians was even larger.

Private Capital Inflows. In late 1985 and early 1986, the central bank first raised, then decontrolled interest rates through a treasury bill tender (see chapter 8). The combination of the depreciation of the dalasi and increased real returns on dalasi-denominated assets led to a turnaround in private capital inflows. Between 1985 and 1988, the private capital component of the balance of payments changed from $ -2.5 million to $2.3 million - an increase equal to about one-sixth of the 1988 current account deficit. In this analysis, I presume (consistent with most observers) that the major stimuli to private capital flows were the float and higher interest rates, and therefore I include this change among the group of policy reforms. The results of a simulation combining the float with the appropriate change in private capital flows (compared to the float alone) are shown in column 5 of Table 2.

The increase in total savings and investment stimulate the industrial and construction sectors. The real exchange rate appreciates as the price of non-tradables (especially construction) increases relative to tradables (especially groundnut processing and reexports). Exports fall and imports grow as production shifts to meet domestic demand. Although output falls in the tradables sectors, growth in the capital goods sectors more than compensates. Higher real incomes raise the demand for food, and agricultural output expands slightly. The stimulus to the investment and agricultural sectors leads to an increase in rural and informal real wages. Formal sector wages fall, with a corresponding increase in formal employment. Overall GDP grows 1.3%. Thus, the float and increased private capital inflows combine for GDP growth of 4.1%.

Reduction of the Import Tariff in the Reexport Sector. The Gambia has been an active entrepot for trade in the sub-region for generations. The reexport trade expanded rapidly in the 1970s as The Gambia kept its tariffs relatively low while neighboring Senegal, Mali, and Guinea-Bissau raised import barriers. In 1987, The Gambia lowered the import tariff on most reexport goods. I simulate this change by reducing the tariff rate in the reexport sector from 33% to 17%. The results are shown in column 6 of Table 2.

The reexport sector expands rapidly, but the loss of government revenue leads to a reduction in total savings and investment. Labor moves away from construction and industry toward the reexport sector. The reduction in demand for investment goods leads to a general price decline, increasing international competitiveness and stimulating exports. Imports fall in each sector except reexports. The growth in the reexport sector dominates losses in the other sectors, and overall output increases slightly. There is little impact on real wages or aggregate employment.

The Policy Package. Column 7 of Table 2 show the results of a simulation of the combination of the five policy reforms considered above (but excluding changes in rainfall and foreign borrowing). Output grows strongly in four sectors - groundnut production, groundnut processing, industry, and construction. The combination of the float and the groundnut subsidy leads to growth in the two groundnut production and processing. The float, private capital inflows, and the reduction in government expenditures lead to an increase in savings and investment (more than offsetting the declines from the groundnut subsidy and lower import tariffs on reexports), stimulating industry and construction.

Mainly because of the increase in demand for investment goods, domestic prices rise, and the international terms of trade deteriorates. As a result, imports increase. Groundnut exports also expand, but other exports (which had used the parallel exchange rate before the ERP) decline as their relative prices fall. Although the net producer price rises in every sector (except public services), the largest increases are in the groundnut sectors, industry, and construction. These activities draw labor from the other sectors, and production in services and reexports falls. Real rural and informal wages increase, while formal sector wages fall, leading to a fall in urban unemployment.

Overall, the policy package generates GDP growth of 5.1% over the three years. This growth accounts for approximately 34% of the difference in growth between the simulation with all seven changes and the no-reform scenario (14.9%, as shown in column 1 of Table 2). Although this growth is significant, The Gambian population grew over 9% during the period. Thus, the policy reforms, on their own, would have been insufficient to provide an increase in per capita income.

d. Rainfall and Foreign Aid

Rainfall. The Gambia's recovery efforts were aided by the return to more normal levels of rainfall after the drought of the early 1980s. Rainfall between 1985-88 was 30% greater than between 1980-84. The end of the drought was the major factor behind a 14.7% increase in grain yields over the period. I simulate this change in the model by increasing the shift parameter in the production function for both the agriculture and groundnut production sectors by a similar amount. The results are shown in column 8 of Table 2.

The resulting strong growth in agriculture and the groundnut sectors drives prices down, improving the international terms of trade. Exports expand in each sector. Overall, output increases by 2.9%, accounting for about 20% of the difference in growth between the simulation with all seven changes and the no-reform scenario (column 1).

Foreign Aid. During the first year of the ERP, most donors were unwilling to provide supporting finance until they were convinced that the government was serious about implementing the reforms. After the government floated the dalasi, raised interest rates, and retrenched nearly 3,000 employees, the donors provided substantial support (see chapter 16). In 1987 and 1988, the government received aid flows averaging the equivalent of 62% and 36% of GDP, respectively. By almost any measure, these resources were huge. However, the numbers give a somewhat misleading impression of the impact of the aid flows on economic growth. Less than one-third of the resources were used to finance current consumption and investment - a dollar amount not very different from historical trends for the country. The bulk of the aid went to pay current and overdue debt service and to increase the government's foreign reserves. In effect, these resources began to rationalize the implicit borrowing The Gambia had undertaken in the early 1980s.

For example, the deficit on the current account of the balance of payments rose from SDR 35 million to SDR 39 million between 1985 and 1987, then fell to SDR 29 million in 1988. Total aid flows in 1988 were nearly SDR 20 million larger than in 1985 - a 50% increase - and yet the current account deficit was SDR 5.7 million smaller. Despite the reduction in the current account deficit (25% in one year), GDP grew 5.5% in 1988 further indicating that factors other than aid were supporting growth.

In the model, I include only the portion of aid flows which were used to finance current consumption and investment. Although the aid used to build up reserves and pay debt service arrears was important in restoring confidence in the economy and strengthening the foundation for long term growth, it did not directly contribute to the economic growth experienced between 1985 and 1988. Of course, in the absence of these aid flows, domestic resources would have had to have been diverted away from current consumption and investment - an effect captured by the baseline scenario.

The results are shown in the last column of Table 2. The sharp expansion in savings and investment stimulates the capital goods sectors - particularly construction - while most other sectors stagnate or contract. Prices rise in each sector, as do real wages (except in the fixed-wage formal category), leading to a decline in international competitiveness. Exports fall in each sector, while imports increase sharply. Higher real incomes lead to increased demand for food, and agricultural output rises 4.1%. Overall, the increased demand for capital goods more than compensates for the fall in exports, and GDP grows by 4.7%.[4]

Thus, foreign aid accounts for about 32% of the difference in growth between the simulation with all seven changes and the no-ERP scenario (column 1). As with the growth from the policy package, the stimulus from aid flows was clearly important, but not sufficient on its own to ensure growth in per capita incomes.

4. Concluding Observations

The model results show that no single factor was responsible for the economic turnaround. A combination of comprehensive reforms, adequate foreign financing, and a little luck with rainfall and world prices were all important in the recovery. The policy reforms, as far reaching as they were, would have been insufficient on their own to ensure a return to growth in per capita incomes. Similarly, donor support alone (despite the massive amount) would have done little more than rationalize the country's debt arrears and build up reserves.

A significant portion of the observed growth resulted from the mutually reinforcing nature of the changes. For example, the float was supported by higher interest rates, improved fiscal discipline, and aid flows. The model reflects those positive interactions. When simulated individually, the effects from the policy package (5.1%) foreign aid (4.7%), and rainfall (2.9%) account for a total of 12.7% growth in GDP. Yet when the same changes are modelled simultaneously from the same base, output grows by 14.9%. The difference is accounted for by the synergistic effects of the various changes. These interactions contributed both to the renewed economic growth and public acceptance of the austerity measures.

Most of the policy reforms improved the distribution of income, as indicated by higher real rural and informal sector wages, increased agricultural output, and decline in urban unemployment. The float and the groundnut subsidy were especially helpful to the poor. On the other hand, the reduction in government expenditure was detrimental to the poor under the assumption that the increased domestic savings were used to reduce foreign borrowing. Under the alternative assumption that aid flows remained constant so that the increased domestic savings could add to investment, the negative

impact on the poor of reduced government spending was largely ameliorated.

Many of the characteristics of the ERP highlighted in this chapter can be found in adjustment programs other countries have adopted. What made The Gambia different was the presence of all of them: a comprehensive program, minimal slippage during implementation, sufficient foreign financing, fortuitous external circumstances, and a conducive political environment. The Gambia's experience suggests that economic reforms can succeed if they are well designed, conscientiously implemented, and receive sufficient domestic and international support.

Endnotes:

1. See Radelet (1992) for a more complete description of the model, including a list of equations and a social accounting matrix for The Gambia. The current model draws from a model of Cameroon developed by Benjamin, Devarajan, and Weiner (1989).

2. Harris and Todaro 1970.

3. $10 million is approximately equal to the amount of interest due on foreign debt. Continued foreign financing of that amount implies debt service simply would not have been paid.

4. Note the classic "dutch disease" effects from both the aid and private capital flows, which stimulate the recipient sectors (mainly industry and construction) while undermining the competitiveness of other sectors.

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The Politics of Economic Reform

Steven C. Radelet and Malcolm F. McPherson

1. Introduction

Perhaps the most intriguing aspect of the ERP was the lack of overt public resistance to the reforms. Despite the massive civil service layoffs, rapid exchange rate depreciation, and large price increases, there were no strikes, rallies, or marches. The stability of the government was never challenged. The government did not have to ban public gatherings, use force to dissuade opponents, jail members of the opposition or declare a state of emergency. The public reacted to the reforms with skepticism but without much outright opposition. Moreover, in March 1987, 19 months after the cabinet approved the ERP and just 14 months after the float of the dalasi, President Jawara was re-elected to a fifth term with 60% of the vote. His party, the People's Progressive Party (PPP), increased its majority in parliament by two seats.

The unusual political success of the ERP raises several questions. Why did the government postpone reform for so long in the face of major economic deterioration? Why did the government decide to introduce major reforms in 1985? Why was there so little protest in The Gambia to reforms which in other countries engender strong, often violent reactions? The remainder of this chapter explores these questions.[1]

2. Reform Postponed: 1975-1985

By the mid-1970s, the ruling PPP had a comfortable hold on power. President Jawara and his party had won the three elections since independence by wide margins, with its strongest support from the rural areas. Economic performance had been robust in the early 1970s, with high world groundnut prices leading to steady growth, large foreign exchange reserves, and essentially no foreign debt.

With the introduction of the first five-year plan in 1975, the role of the public sector expanded dramatically (see chapter 2). Instead of providing a solid foundation for economic expansion and improved social welfare, the plan had the effect of politicizing most aspects of economic decision-making. Opportunities for special interest groups, bureaucrats, and politicians to manipulate public resources for their own benefit expanded. The PPP was comfortable with its rural political base, and used government institutions to maintain its support and extract resources for its own benefit. The government established several urban-based parastatals, increased public investment dramatically, and doubled the size of the civil service. Urban-based businesses - particularly tourist hotels - reaped the benefits of loan guarantees and "development certificates" that gave generous tax breaks. Urban residents also gained from low interest government loans; the overvalued exchange rate; and subsidized rice, utilities, and transport.

One source of financing for this system was groundnut receipts. Marketing board profits per tonne of groundnuts averaged 47% of the farmgate price between 1974 and 1978. Most of these funds were transferred to the central government to help cover its burgeoning deficits. The remaining government deficits were financed by grants and loans from donors and borrowing from the banking system.

Despite the massive transfers from groundnut farmers, the PPP was able to keep its rural support largely through the activities of The Gambia Cooperative Union (GCU), which became a conduit between the rural areas and the government for the party. The GCU directed its membership the benefits of its virtual monopsony in domestic groundnut marketing and priority access to seed, fertilizer, and subsidized loans. Along with the GCU, a small number of well-placed rural roads, river wharfs, schools, and health clinics ensured the support of important rural leaders. Finally, the extent of the threat to rural political support from the urban policy bias was mitigated by the government's financing a large part of the public sector expansion by foreign borrowing. Loans entailed few immediate costs to any one group. The burden of foreign debt would only become evident over time, and even then would be spread out among taxpayers. However, the political benefits to the government from these loans were large and immediate.

The 1981 attempted *coup d'etat* provided surprisingly little immediate stimulus to change the existing system. The eight-day uprising, which left an estimated 1,000 dead, was finally put down by 1,500 Senegalese troops called in by President Jawara under a mutual defense treaty. The prevalent view was that the rebels were a small group, perhaps supported by Libya, with only limited popular support. Policy maker's who believed that the rebellion did not reflect widespread dissatisfaction had little reason to advocate a change in government policy in response. Indeed, the unrest may have helped prop up the existing system: donors quickly expanded their financial support, and the government increased public sector wages in an attempt to garner more support from the civil service.

Despite the rapid economic deterioration in the early 1980s, there were no recommendations for basic changes in policy from government economic and financial technicians. The few major economic analyses generated domestically during the period largely ignored the growing public sector deficits, diminishing foreign exchange reserves, and emerging parallel markets, surmising that the economic difficulties were the result of continued drought, low world groundnut prices, the oil shocks, and the attempted *coup d'etat*.

Donors did not advocate major reform in The Gambia, either, at least up until early 1984. Indeed, a 1981 World Bank study concluded that "the economic policies of the government, including

producer prices, have been quite satisfactory ... (and) the poor growth record of the 1970s was almost exclusively attributable to unfavorable weather conditions".[2] Although some individual consultants financed by aid agencies called for reform as early as 1979,[3] the international community continued to provide substantial financing without pressure for policy reform. Thus, with neither government policy makers and government technicians nor donors urging economic reform, economic policy remained unchanged and the economy continued to deteriorate into 1985.

But the situation facing Gambian policy makers was changing in 1984 and 1985. The critical difference was the lack of foreign exchange. Reserves were depleted, debt service arrears were mounting, and export earnings remained low. The country was essentially bankrupt. With shortages emerging for imported goods, the government made an emergency appeal for financial assistance to the United Kingdom, but was refused. The British government said that it was unwilling to continue aid flows in the absence of major reform. Other donors adopted a similar stance. If the donors were truly serious about withholding assistance, the government would no longer be able to finance such a large current account deficit. Without aid, the question was not *whether* but *how* to adjust.

3. Government Deliberations

a. The Economic Options

As the shortages worsened, pressure was mounting on the government for some sort of action. As described elsewhere (see chapter 2), the Minister of Finance Sheriff Sisay assembled a task force to develop a program for economic reform.

When Sisay submitted the report produced by the task force to the president and the cabinet, there was no guarantee that they would approve the program. They had three options. First, they could have done nothing. If they chose this option, and the donors continued to withhold aid, the economy would collapse. On the other hand, if the donors decided that they could not permit that to occur to one of the few democracies in Africa, they may have provided emergency support. Aid would have continued to prop up the system, with the economy sputtering along as it had in the early 1980s. A vital question for the president and the cabinet was whether the donors were serious about withholding aid.

The second option was to adopt some of the recommendations and negotiate with the IMF for a standby program - in effect, attempt to implement as few changes as possible, but enough to obtain support from the IMF and other donors. But The Gambia was in arrears to the Fund, and the Fund's Board of Directors was moving toward declaring The Gambia ineligible to borrow. The arrears would have had to have been paid before an agreement could be

signed, and the government did not have the foreign exchange for that. Financing would have to be found from another source first. It was not clear that the promise of a stabilization program on its own would have been enough to convince other lenders of The Gambia's sincerity or creditworthiness.

The third option was to accept the task force's recommendations. The proposed program offered the prospect of renewed economic growth and an end to the shortages. It would also result in financial support from the donor community. But renewed growth was by no means guaranteed with this kind of program, as other countries which were undergoing structural adjustment were discovering at the time. Indeed the economy might have continued to stagnate, particularly during the initial stages of reform. Comprehensive changes also meant greater administrative difficulties - a concern in a country with so few well-trained managers and technical specialists. Moreover, the proposals would have brought about a redistribution of income and the loss of government control over access to domestic resources, and thus the possibility of strong political opposition. Deciding to accept the task force recommendations was effectively a decision to change the system upon which Gambian political economy had been based since independence.

b. The President's Role

In choosing among these options, only one vote really mattered: the president's. President Jawara had been the country's leader since independence, and little could be accomplished without his support. This view has been succinctly expressed by opposition political leaders: "In The Gambia the Parliament does not matter, the political party does not matter, the civil service does not matter, the only person who matters is the President of the Republic".[4]

While subject to some poetic license, that statement reflected the influence wielded by the president. Jawara came to the forefront of the PPP in the late 1950s through his ability to forge a consensus among the most powerful rural chiefs. He has been the leader of the PPP ever since. With the extension of universal suffrage to the rural areas in 1963, the PPP gained a strong majority in the pre-independence Legislative Assembly, with Jawara as Prime Minister. He led The Gambia to independence in 1965, and is seen by many as the father of the country. He has not been seriously challenged in any of his six bids for re-election. The Gambia's democratic institutions and strong human rights record since independence have enhanced his stature both domestically and internationally.

With his background as a veterinarian, the president had always relied on his advisors to determine economic policy. Most of those whom he could have called on for advice in 1985 were poorly trained in economics, and their earlier economic advice had proven

ineffective and even detrimental. While there was some dissent on specific aspects of the proposed program - the central bank was opposed to any exchange rate adjustment, for example - none of the president's advisers, nor anyone else inside or outside of government, presented any credible alternative to the ERP. Sisay, on the other hand, had been minister of finance in the early 1960s during a period of relative economic prosperity; had been the first governor of the central bank; and held a graduate degree in economics. He held early leadership positions in the PPP and was one of the few remaining active original members of the party besides the President. This background undoubtedly strengthened Sisay's position in influencing the president's decision on the program. Eventually, Sisay's leadership ability would prove to be critical to the success of the ERP.

Despite the critical state of the economy, domestic political pressures were strongly against reform. No important citizens groups or private businesses supported the reforms proposed by the task force. Representatives of the Chamber of Commerce and Industry and the commercial banks opposed the ERP during their meetings with the minister of finance. The central bank resisted any exchange rate reform, arguing that the 25% devaluation in 1984 had been ineffective. Civil servants were against the wage freeze and the proposed staff reductions. Parastatal managers opposed credit restrictions and the notion of performance contracts. The groundnut marketing board, while favoring a higher groundnut price, was uncomfortable with the prospect of having its financial performance closely scrutinized by the ministry of finance and the IMF. Finally, the rest of the cabinet initially opposed the reforms. Few, if any, seriously believed the donors' threat to completely suspend aid (see chapter 2), and they viewed the crisis as Sisay's problem, not theirs.

Finally, and perhaps most importantly, the president had to be concerned with the possibility of another attempted *coup d'etat* and about the elections scheduled for early 1987, just eighteen months away. However, it was not clear whether inaction or reform posed the greater political threat. Inaction could have easily led to political discontent. Shortages of some imported commodities were already severe, and prices were rising rapidly in parallel markets. If the donors had continued to withhold aid, these problems would have intensified, further undermining the tax base and weakening the government's position. Reforms obviously carried their own political risks from major protests, strikes, or violence, as had happened in other African countries. The same dilemma which confronted all reform-oriented governments was evident in The Gambia: urban pressure groups did not want the continued economic deterioration associated with current policies or the medicine of reform. What they wanted - high levels of public spending and low prices - the government could no longer provide.

In one very important respect, the risks in The Gambia were greater whatever the choice. Whereas many African governments face the prospect of the loss of power from political unrest, many Gambians perceived that they were confronted by the possibility that the country itself would disappear. A major disturbance in The Gambia - either from continued economic deterioration or in protest of reforms - could have led to the overthrow of the Jawara government and the incorporation of The Gambia into its neighbor, Senegal.

C. The Gambia's Relationship With Senegal

The existence of The Gambia has long created economic and political difficulties for Senegal. The Gambia effectively divides Senegal into two regions, making it costly and inconvenient to transport goods from the north to the south. The two regions differ ethnically, economically, and politically, and a secessionist movement has been active in the south.

The 1981 attempted *coup* in The Gambia permanently changed the relationship between the two countries. As mentioned previously, Senegalese troops finally put down the rebellion. Most of the troops left shortly afterwards; however, some Senegalese troops remained in The Gambia until 1989.

In December 1981, five months after the attempted *coup*, with The Gambia's security clearly dependent on Senegal, the two countries agreed to form the Senegambia Confederation. Throughout the 1980s, a Confederal Parliament met regularly, and protocols were signed in the areas of mutual defense, transportation, arbitration, communications, and cultural exchange. Negotiations also took place on a free trade area, a monetary union, and other issues. The Gambia, fearing complete domination by its larger neighbor, moved slowly and cautiously in negotiating these agreements. Senegal, on the other hand, was interested in moving toward complete integration as quickly as possible.[5]

With this history in mind, many people both inside and outside The Gambia believe that if there is another major disturbance in The Gambia, Senegal could use the opportunity as a pretext to take over.

The Gambia's relationship with Senegal was a factor in the donors' refusal to provide emergency aid in 1985. Several donor officials recounted in private interviews that there was some sentiment within their respective organizations to withdraw support and allow the Gambian government to fall. Although reluctant to see a western-style democracy disappear, that Senegal (and not some unknown group) would take over made the potential downfall of the Gambian government less problematic. The Senegalese (and the French) would welcome such a result, the "problem" of The Gambia would be solved, and the outcome would serve as a warning to other countries reluctant to undertake adjustment measures that the donors would not necessarily always bail them out.

Donors and diplomats felt that this pressure was critical in the president's decision to adopt the ERP. Continuing economic decline without donor support probably would have, as one diplomat put it, "eventually forced President Jawara to go hat in hand to President Diouf" of Senegal. Minister Sisay was clearly aware of this possibility. He later observed that "in assessing the impact of the ERP it is also relevant to consider whether The Gambia's integrity as a nation would have long withstood an IMF's declaration of ineligibility and the regional pressures this would have generated".[6]

Thus, while technical analysis and international pressures were both pushing the president toward adopting the ERP, bureaucratic and institutional factors were pressing him in the opposite direction. The fact that Sisay supported the measures contained in the ERP and the president eventually agreed suggests that they concluded, with much trepidation, that economic reform posed the least political threat. By mid-1986, it was clear that they had been right.

4. Political Acceptance

a. Lack of Opposition

The lack of public opposition to the reforms is perhaps the most striking and puzzling aspect of the ERP. Why were there no demonstrations, marches, strikes, riots, or other disturbances? How did the PPP win re-election so easily so soon after initiating the ERP?

There are several answers. One important factor is the nature of the political system and the political power base in The Gambia. The Gambia is a democracy - a rarity in Africa. There is universal adult suffrage, and voting in the six general elections since independence has been widely acknowledged to have been free and fair. Freedoms of speech, religion and the press are guaranteed by the Constitution. Political parties need not register and are free to campaign actively.

These political freedoms notwithstanding, the PPP has totally dominated politics in The Gambia since independence. The 75% of the population living in rural areas, mainly Mandinka and Fula farmers, form the backbone of the party's constituency. The country's small size and the accessibility of rural villages contributes to the rural power base as well. Essentially all villages are linked by roads, and even the most distant village is only an eight-hour bus ride from Banjul. Consequently, rural dwellers are not geographically (and thus not politically) isolated.

The rural political power base - rare in Africa - combined with the specific impact of the policy reforms, helps explain the PPP's easy electoral victory so soon after the implementation of the ERP. The reforms which tended to hurt mainly urban dwellers - the float of the dalasi; higher interest rates, petroleum prices, utility rates, and transport fares; and the retrenchment of civil servants - did little to erode the party's historic base of support. Other reforms, such as the liberalization of the rice trade and, most importantly, the increased groundnut producer price, directly benefitted the party's rural constituents. Those policy changes and the end of the drought helped increase per capita real income in the rural areas by approximately 12% between 1985 and 1988.

Although these factors contributed to the electoral victory of 1987, they do not fully explain why there was so little overt *urban* opposition to the reforms. On reason was that urban dwellers perceived the government to be both legitimate and stable. The crisis the government faced was economic, not political.

A second reason is the lack of any group which might serve as a focal point for active opposition to the reforms. Opposition parties were small and unable to mount a credible challenge to the PPP, despite the economic crisis. Labor unions were small in number and size, and were politically weak. University students often spark political opposition, but The Gambia does not have a university. The military was small, apolitical, and conscious of the larger army in Senegal (with troops stationed in Banjul) and how it might react to trouble in The Gambia. Civil servants were not organized, and the possibility that troublemakers might be the first to lose their jobs during the retrenchment exercise contributed to the lack of protest. Thus, none of these urban groups were able to spark public protest.

Finally, while urban dwellers clearly bore the bulk of the costs of the reform measures, the impact on urban dwellers was not as great as it might have been. This was partly due to the design of the policy package. The reforms were comprehensive and many were mutually reinforcing, easing the negative economic impact on any one group. For example, the liberalization of interest rates, the customs crackdown, the reduction in government expenditure, and the limits on domestic credit all reduced the extent to which the exchange rate depreciated. As a result, real incomes declined by less than many had mutually feared.

b. Government Leadership

Moreover, the government reduced resistance by the way in which it introduced the ERP. It took several steps to make information available to and receive feedback from the public about the program. The contents of the daily task force meetings, while officially confidential, were discussed all over town each evening. President Jawara and Minister Sisay presented the details of the

program in a series of speeches, and the government made full written descriptions available to the public. Minister Sisay discussed the reform measures in several meetings with representatives of local businesses, commercial banks, traders, and the Chamber of Commerce. President Jawara made a special point of discussing the ERP in rural areas during his annual "meet the farmers" tour. These government actions made the public more aware of the problems they faced, the available options, and the prospects for improvement with the ERP, thereby helping to reduce public opposition.

c. Aid and Luck

The burden on urban dwellers was eased further by the resources provided by donors. Foreign aid supported the exchange rate and allowed both consumption and investment to be higher than they otherwise would have been during the adjustment period. Many of the civil servants who lost their jobs were either absorbed into the growing sectors or joined relatives on farms to take advantage of the high returns offered to groundnut producers. That displaced urban workers found employment opportunities contributed to the lack of public opposition to the program.

Lucky breaks, particularly in the world price of rice and the amount of rainfall, also defused potential opposition. The end of the drought enhanced rural incomes, increasing the demand for urban-based products and services. Moreover, the dalasi price of rice (the urban staple food), which more than doubled just after the float, quickly fell to below its pre-float level because of lower world prices and increased domestic production. The fall in rice prices was critical to urban acceptance of the reforms. One diplomat called it "the lucky break The Gambia needed."

Possibly the most important factor mitigating public opposition was the legacy of the 1981 attempted *coup d'etat* - only four years prior to the ERP - and The Gambia's relationship with Senegal. Gambian citizens were thinking about more than the immediate economic impact of the ERP: they worried about the continued existence of their nation. Although urban residents were not particularly happy with the ERP, they did not want a repeat of the violence and bloodshed of the coup attempt. This, perhaps more than any other factor, helped minimize public opposition to economic reform in The Gambia.

5. Concluding Observations

Several lessons emerge from the Gambian experience. First, democratically elected governments <u>can</u> implement strong stabilization programs. The Gambia is one of a growing number of democracies that contradict the notion that popularly elected governments cannot implement comprehensive reform programs.[7] More

important, however, as shown in The Gambia and elsewhere, is the strength and autonomy of the government.[8] The PPP's large majority in parliament, President Jawara's long tenure in office, the perceived legitimacy of the government (both domestically and internationally), and the weakness of opposition allowed the government to introduce a broad and comprehensive reform program.

Second, The Gambia provides an interesting counterexample to the conventional wisdom that political leaders cannot introduce austerity measures just before an election.[9] The government floated the currency; laid off 20% of its workforce; sharply raised interest rates; and increased utility, petroleum, and transport prices - all within the fourteen months preceding the elections. Yet, it was comfortably re-elected.

Third, The Gambia's experience shows that governments can take steps to help manage potential opposition, implying that political reactions may be at least partially endogenous to economic reform.[10] Minister of Finance Sisay established a task force comprised primarily of Gambian technicians to design the ERP, giving the government a measure of control from the outset that it would not have had were the program designed by the IMF and the World Bank. As a result, the ERP was seen as a Gambian program, enhancing acceptance both within cabinet and among the general public. Furthermore, the government helped ease opposition to the program by keeping the public well informed and by holding open public discussions of the ERP.

Fourth, Gambians were concerned not only with their short term economic interests, but their national sovereignty. The possibility that political unrest - either as a result of continued economic deterioration or in response to reform measures - could eventually lead to the demise of The Gambia as a nation helps explain both the government's decision to undertake reforms and the subsequent lack of overt public opposition.

Fifth, the leadership of specific individuals was decisive. Minister of Finance Sisay was probably the only person in the government capable of successfully introducing and implementing a comprehensive reform program. His background, record, and training equipped him to head the effort and enabled him to simultaneously gain the trust of the president, the public, and the donors. President Jawara's long tenure in office gave him authority and influence. His support was crucial not only for the initial acceptance of the ERP, but for the continued implementation of individual reforms as well.

Sixth, the international community played a vital role in The Gambia's reform. The donors' refusal to continue financing the current account deficit was critical to the government's decision to adopt the ERP. Substantial aid flows and technical assistance which followed the introduction of the reforms helped ensure the

quick economic turnaround thereby easing opposition, particularly in urban areas.

Seventh, The Gambia benefitted from lucky breaks in rainfall and the price of imported rice. The end of the drought provided immediate economic relief throughout the economy. The fall in the world price of rice just after the float of the dalasi helped stabilize its price which further eased the economic cost of the reforms to urban residents.

Finally, the Gambian experience highlights the link between economic and political success in economic reform programs. The economic recovery in the rural areas helped the PPP gain reelection, while the moderate negative impact on urban consumers reduced opposition to the ERP. At the same time, the political success of the program raised investor and consumer confidence, helping to reverse capital flight and stabilize the economy.

Endnotes:

1. For more detailed analyses of the politics of reform in The Gambia, see McPherson (1991) and Radelet (1992).

2. World Bank 1981:i.

3. McPherson 1979.

4. West Africa, December 15, 1980.

5. The Confederation was dissolved - on unfriendly terms - in September, 1989.

6. GOTG 1987:20.

7. See Haggard and Kaufman (1989) for a discussion on regime type and economic reform.

8. Nelson 1990.

9. Ibid. 1990.

10. Grindle and Thomas 1991.

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The Program for Sustained Development

Brendan M. Walsh

1. Introduction

The Economic Recovery Program (ERP) covered the period 1985 to 1989. It was introduced during a national emergency and was viewed as a package of measures that called for great sacrifices which were justified in order to save the economy, indeed the nation, from collapse. The crisis-laden overtones of the ERP created a presumption that when the country had weathered the storm there would be scope for relaxing the austerity measures that had been put in place.

As the period of the ERP drew to a close it could indeed be claimed that the economy had been stabilized. Inflation had declined, the fiscal deficit had been sharply reduced and arrears of external debt service eliminated, the foreign exchange system was functioning smoothly and the level of external reserves was adequate. The success of the ERP gave the government the option of allowing it to expire without fanfare, putting nothing in its place. However, the government felt the need to launch the Program for Sustained Development (PSD) in 1990 as a successor to the ERP.

To understand why this was the case, it is helpful to review the achievements and the unfinished business of the ERP and the context in which the PSD was introduced. Section 2 considers those achievements. Section 3 outlines the program for sustained development. Section 4 considers challenges for the future. And, section 5 has concluding observations.

2. The Achievements of the ERP

a. Restoring Economic Discipline

The ERP, unlike the development plans which had preceded it, was not an exercise in detailed economic planning. It contained no sectoral blueprints and set no detailed targets for the growth of output, employment or other macroeconomic variables. As has been described in other chapters, it consisted of a set of policy orientations, including the liberalizing of the markets for credit, essential commodities and foreign exchange, curtailing the size and scope of the public sector's role in the economy, increasing the efficiency of the civil service and concentrating public sector spending on creating a favorable environment for private sector investment. The program was linked to an action plan agreed with the International Monetary Fund (IMF) and the World Bank that formed the basis for the credits made available to The Gambia when the ERP was in place.

As the period of the ERP drew to a close, there was little pressure to abandon the policies that had been introduced under it. The recovery program had worked well in the sense that markets were

functioning smoothly and shortages and rationing were no longer features of everyday life, as they had been in the mid-1980s. However, the retrenchment of civil servants and the tight controls imposed on public expenditure that were integral parts of the ERP were unpopular and widely viewed as restrictions from which the country would escape as soon as the crisis in the public finances was over. An important purpose of the PSD was to reaffirm The Gambia's commitment to the market-oriented reforms contained in the ERP and to dispel the idea that discipline imposed during the ERP was a temporary expedient. Furthermore, the wide-ranging structural reforms to which the country committed itself in 1985 were by no means completed by 1989. A start had been made, but a great deal remained to be done.

Moreover, the 4.5% growth rate in real GDP envisaged in the ERP allowed for only a one per cent a year improvement in real incomes per capita. The new program set the goal for the growth of GDP at 5.5% a year, which would double the rate of growth in income per capita.

b. The IMF Program

Throughout the period of the ERP, macroeconomic policy had been formulated in the framework of agreements under the IMF's Standby, Structural Adjustment and Enhanced Structural Adjustment Facility (ESAF) and World Bank Structural Adjustment Loans (SAL). Conditions agreed with bilateral donors, notably USAID, had also to be observed. It is important to realize the scope of these agreements and the constraints they placed on Gambian policy in the economic sphere. Under the IMF program the Government was committed not to incur any new debts except on highly concessional terms; the stock of external payments' arrears was to be eliminated by mid-1990; lending to state-owned enterprise was ruled out except in specified cases; limits were set to the growth of the domestic assets of the banking system and targets were specified for the accumulation of external reserves and government's balances with the central bank. Indicative figures for government revenue and recurrent expenditure, and hence for the fiscal deficit, were laid down. In 1990/91 a ceiling on current expenditure (excluding debt service) was included in the program.

At the core of the IMF program is a monetary programming framework in which the growth of the money supply is curtailed to equal that of predicted money GDP. There is a programmed increase in the foreign reserves component of the money supply, while the domestic asset component declines. The programmed contraction of "net credit to the government" component is more rapid than that of total domestic credit, so room is left for private sector borrowing to expand. The increase in the reserves is programmed on the basis of projected inflows of non-project external financing (including monetized commodity aid), the receipts of the Gambia Produce Marketing Board (GPMB) from the export of groundnuts and cotton,

and central bank purchases of foreign exchange from the interbank market. The build-up of the government's balances with the central bank is based on the inflows of non-project financing and the balance between domestic revenue and expenditure over the year.

The essence of this macroeconomic adjustment package therefore consists of using non-project ("balance of payments" or "budgetary") external assistance to build up the country's external reserves and to reduce the public sector's net credit from the banking system, thereby freeing up financial resources for the private sector within an overall ceiling on credit expansion.

Several factors need to be taken into account in order to appreciate the emphasis in the IMF program on building up foreign exchange reserves and sterilizing foreign exchange inflows. Starting from a situation in 1986 in which the country's foreign exchange reserves were completely depleted and a sizeable stock of external debt service arrears had accumulated, The Gambia used the inflow of balance of payments support during its arrangements with the IMF to eliminate arrears and build up its external reserves. By mid-1991, at the end of the third annual ESAF arrangement with the Fund, reserves had increased to the equivalent of five months import cover. (If imports for re-export are excluded, the reserves represented eight months cover.) This was a target set at the start of the reform program with a view to meeting the projected balloon of interest and principal repayments that would occur as rescheduled Paris Club debt came due early in the 1990s. In fact cancellation of debt by the *Caisse Centrale* and other debt forgiveness have rendered the bulge in debt service less dramatic than was forecast. Having attained the target for official reserves it will not be necessary to run them down as sharply as had been anticipated. However, even though The Gambia is operating a floating exchange rate system, the extreme openness of the economy and its vulnerability to external shocks dictate that an adequate level of reserves is indispensable if confidence in the currency is to be maintained and the foreign exchange market is to continue to function smoothly. But the commitment to build up reserves and the need to offset the growth in liquidity generated by its purchases of foreign exchange, the central bank increased the stock of treasury bills held by the non-bank public. This has placed upward pressure on interest rates and increased the burden of internal debt service. By the end of 1991/92 the target level of reserves will have been reached, which will reduce the need to sterilize further net inflows of foreign exchange and allow them to affect the exchange rate.

The precision with which the revenue, expenditure and credit targets have been specified in the IMF programs and the emphasis placed on the attainment of these targets would have been daunting in an economy in which in international trade were relatively unimportant. In a small open economy such as The Gambia the difficulty of adhering to preset targets is magnified by the impact

of external shocks. Revenue is affected by the level of activity in the tourism sector and the re-export trade, as well as by the level of domestic spending, which in turn is affected by the groundnut harvest and world groundnut prices. Recurrent expenditure is affected by the level of world interest rates, the exchange rate and the trend in import prices.

It is remarkable that, despite the importance of these imponderables and the shocks administered to the economy by events such as the break-up of the Senegambia Confederation in 1989, the Gulf War in 1990/91 and the deep recession in the United Kingdom over the period 1989-92, the annual targets for both revenue and expenditure in the financial years 1989/90 and 1990/91 were met to within one per cent. The closeness which the budget adhered to these targets is an indicator of the degree of control exercised by the IMF program on the conduct of the day-to-day management of the economy. Furthermore, during the last year of the ESAF program, the IMF ruled that targets that had been negotiated on the assumption of a certain level of non-project aid inflows would only be adjusted by 25 per cent of the net shortfall in these inflows. During the financial year 1990/91 a net shortfall of D125 million occurred, primarily due to the non-disbursement of the second tranche of the World Bank SAL-II and related financing. The Fund adjusted the targets for external reserves and the government's balances with the central bank by only one quarter of this shortfall. To meet these targets, therefore, a gap of D94 million had to be filled. This was equivalent to 17 per cent of budgeted expenditure.

It is clearly unreasonable to expect the country to adjust expenditure and/or revenue on this scale in the course of the fiscal year as it becomes clear that the shortfall is emerging. On the other hand, the Fund wishes to ensure that the country has an incentive to do all in its power to meet the conditions attached to the non-project financing. The Fund based the disbursement of the last tranche of the ESAF on the end-March outturn, but programmed the SAL-II disbursement for the quarter ending in June. This increased the probability that the Fund could disburse even if, as became increasingly clear in the course of the year, the World Bank's conditions were not going to be met.

c. Other Donors

In addition to macroeconomic targets, the IMF and World Bank programs also specified a wide range of structural reforms. A major component of this program was the reform the state-owned enterprises. These operated in all sectors of the economy - public utilities, crop marketing, banking, ferries, a shipyard, a mechanical workshop, a cotton ginnery. The immediate goal of the reform package was to break the intimate links that existed between these enterprises and government which in the pre-reform era had led to widespread inefficiencies and mutual indebtedness between

government and the enterprises. In most instances the ultimate solution envisaged is privatization. Structural reform also involved the phasing out of subsidies to agriculture either through preferential credit or supplies of below-cost fertilizers or seed. Projects included in the public investment program (PIP) have to demonstrate an economic rate of return ("where calculable") of 15 per cent, "while projects in the social sectors, where economic rates of return cannot be determined, must be selected on the basis of least-cost alternatives".

The World Bank matrix of policy reforms overlapped to a large extent with the IMF's program in this area, although its range was wider and the terms of its conditions less precisely specified. The main emphasis of the USAID African Economic Policy Reform Program grant agreements was that all domestic lending would be at "market-determined" rates, while PL 480 food aid was conditional upon agreeing to a schedule for privatizing the GPMB. Other donors (the UK, the European Community, the African Development Bank) attached additional conditions to their grants and loans. The interpretation of the individual structural conditions often involved protracted exchanges between Banjul and Washington, D.C.[1]

Furthermore, the process of designing, supervising and reviewing the multiplicity of projects contained in the PIP absorbs a great deal of the attention of local officials. Most of these projects involve considerable overseas travel, which results in the disruption of administration.[2] There was a significant deterioration in the local capacity to implement projects in the late 1980s, provoking serious concern at the World Bank about the lack of success in improving productive infrastructure over the period of the ERP.

3. The Program for Sustained Development

The reason for dwelling on the details of the structural adjustment program in the context of the transition from the ERP to the PSD is to highlight the extent to which the management of the economy of The Gambia had been guided from the outside during the period of the ERP. One of the achievements of the ERP was that it restored donor confidence in the country and resulted in a greatly increased inflow of external project and program assistance, conditional on the implementation a comprehensive set of reforms (see chapter 16). Coincidentally, within a year of the expiry of the period of the ERP, the country's program with the IMF came to an end. The Fund's Staff Review, discussed by the Board in mid-July 1991, was based on performance to end-March, so that in effect the targets for March 1991 were the last on which disbursement of a credit depended. While it was agreed that a close policy dialogue would be "highly desirable" following the conclusion of the ESAF program, and "economic and financial targets" for the year 1991/92 were agreed, no further disbursements of IMF credits depend on meeting these targets.

Furthermore, despite the difficulties encountered in convincing the World Bank that the conditions for the disbursement of the second tranche of SAL-II have been met, it is anticipated that these will be resolved, and the final tranche of SAL-II disbursed, early in the 1991/92 financial year. There are no immediate plans for a third SAL. Thus in 1991/92 the country faced a future free from the heavy burden of conditionality with which it had struggled since 1986.[3]

Against this background the launching of the PSD was significant in that it represented a clear statement that although the crisis conditions under which the ERP had been adopted were over and the end of the tight conditionality imposed by the IMF was in sight, it was not government's intention to abandon the commitment to prudent fiscal and monetary policy and structural reforms that guided the economy for the previous five years. The document itself was brief and dealt with the direction of macroeconomic policy and structural reforms only at a general level.[4]

The intention of maintaining continuity with the ERP was clearly stated. The need to accelerate the rate of economic growth was emphasized. It was pointed out that because of rapid population growth a 3.5 per cent growth rate was required just to prevent living standards from declining. Attention was drawn to the fact that the gap between countries like The Gambia and the rapidly-growing countries of South East Asia was widening. Even if a growth rate of 5.5 per cent were achieved, living standards would improve at only 2 per cent a year and the standard of living in the year 2000 would remain extremely low.

The PSD also acknowledged that the program of structural reform that was linked to the ERP had by no means been fully implemented by 1989. Delays due to unforeseen problems, lack of administrative capacity and in some areas lack of commitment to unpalatable actions led to serious slippage. The wide-ranging divestiture program was far from completed in 1989. While the government had sold its minority shareholdings in several companies, and a number of small enterprises had been privatized, all the major institutions - the Gambia Produce Marketing Board, the Gambia Commercial and Development Bank and the Gambia Utilities Corporation - were still in government ownership. Many thorny issues had to be tackled in the course of 1990 and 1991 before visible progress was made in these areas.[5]

The PSD spelled out the strategy that would achieve faster growth. The main components of it are:

- a reliance on the private sector as the primary source of the investment which generates employment and incomes for the working population;

- a relatively small but efficient public sector which concentrates on providing essential public services and productive infrastructure and creating an environment conducive to private sector investment; and
- continuing market-oriented policies in relation to the key prices in the economy.

In particular, the liberalized exchange rate system will be maintained, credit markets will continue to be unregulated and interest rates to be determined by the supply and demand of funds in the interbank market, no restrictions will be placed on imports and existing rates of duty will be maintained or lowered in the interest of improving The Gambia's price competitiveness in the sub-regional market. The program looked forward to continued support from the country's traditional donors and increased assistance from new sources.

4. Challenges for the Future

The declared commitment to the role of private sector investment as the locomotive of growth in The Gambia, contained in the ERP and repeated in the PSD, is not entirely convincing for two reasons. In the first place the contribution of private sector savings and investment to development over the period since the start of the ERP has been relatively minor. Although it is estimated that gross domestic savings increased from 4.7 per cent of GDP in 1986/87 to 8.5 per cent in 1990/91, they still constitute less than half of gross national savings, which are estimated to equal 20.7 per cent of GDP in 1990/91. A preponderance of investment is still undertaken by the public sector. Secondly, as we noted above, part of the rationale for the PSD was an appeal to the international donor community for increased assistance.

Following the launch of the PSD a Round Table Conference was held in Geneva under the auspices of the UNDP in December 1990 at which the case for increased assistance from donors was presented. The inconsistency between the appeal for more assistance to be channelled through the government's budget (even if most of it is to be for infrastructure) and the rhetoric of the private sector as the engine of growth was not addressed at this conference and it remains an anomaly in the government's thinking about the development of the economy.

It is, however, fully consistent with a policy of reliance on private sector investment in the commercial areas of the economy to increase the resources being allocated to social overhead and productive infrastructure investment in the public sector. Decades of exceptionally generous external project assistance notwithstanding, the deficiencies in skills and educational levels, in public utilities, and in transport in The Gambia are glaring and a serious obstacle to private sector investment. It is not

entirely coincidental that some of the language in the PSD echoes that contained in the World Bank publication Sustainable Growth with Equity: A Long-Term Perspective for Sub-Saharan Africa, which appeared in mid-1989. The strategy described in the PSD was in keeping with the renewed emphasis by the international donor community on "strengthening the enabling environment" through the reorientation of incentives and improvements in infrastructure. The World Bank stated that

> An enabling environment creates the conditions for higher productivity, but growth rates will only be raised and sustained if African capacities are much enhanced.[6]

The required capacity-building has three components:

- human development, especially improved health and education standards;
- the provision of incentives for skilled workers and managers to perform effectively; and
- political leadership and "good governance".

The PSD adverted to all three of these areas, recognizing the urgency of raising the ability of the population to participate effectively in the wealth-creating process. The poor health status of the population and the lack of technical, craft and managerial skills in the work force are acknowledged as major obstacles to the development of the country. A higher priority for the ministries of health and education in the budget is proposed in response. In keeping with this commitment, and in response to pressure from the World Bank and the IMF, the share of the recurrent budget devoted to health was increased to 10.7 per cent and that devoted to education to 21.0 per cent in 1991/92. The government plans to continue to increase the allocations to these ministries throughout the PSD. However, the level of resources represented by these allocations are very modest relative to the magnitude of the task of achieving the standards of health and education required to enable the population to participate effectively in the process of development. Moreover, it is clear that larger budgetary allocations are not a sufficient condition for achieving this goal. Problems have emerged in the absorption and management of the available resources and the need to raise the quality of the services being provided is as urgent, if not more so, as the need for additional resources.

The Gambia is a particularly challenging test of the philosophy of development that relies primarily on "creating an enabling environment" and hoping that domestic and foreign private sector investment will prove to be the locomotive of economic growth. The country's small size, its limited natural resource endowment and peripheral location, the low level of human capital and the legacy of the shocks and mistakes of the 1970s and early 1980s all render a private sector investment boom improbable. The financial reforms

of the ERP have liberalized exchange rate and interest rate systems. Market determined exchange rates and the absence of exchange controls combined with high positive real interest rates have not led to a return of capital that fled the country under less favorable circumstances or an inflow of new private funds.[7] In the competition for the limited amount of footloose direct inward investment from the developed world, The Gambia has no edge over numerous alternative locations. Local funding and expertise are limited and highly concentrated in a minority group whose comparative advantage lies in trading and services rather than production. However, a number of sectors have clear development potential. The most promising are tourism and tropical horticulture. Problems of quality control and price competitiveness will have to be overcome and major improvements in the relevant infrastructure (the airport and power supplies in particular) achieved before this potential can be realized. The commitment to creating a favorable environment for private sector investment should concentrate on rapid and tangible improvements in these areas.

The effect of the tight conditionality imposed by the donor community over the second half of the 1980s on The Gambia's internal priorities will be crucial for the sustainability of growth in the future. When the country was under conditionality from donors, the penalties for failure to meet targets were significant. The threat of non-disbursement of a tranche of a loan or grant was real and the potential embarrassment to the government considerable. There are now fewer conditions to be met, less depends on meeting them, and the supervisory role of the IMF and the World Bank is being reduced. Spending ministries and the ministry of finance and will have to maintain the discipline that was imposed by tight conditionality simply because good economic management demands it.

The British legacy to The Gambia extended to the design and financing of the country's public sector capital spending during the early years of independence. With the passage of time the sources of this support were broadened to include a wide range of donors and international agencies. More than 80 per cent of the country's development budget is still financed by external grants and loans. The extent to which the priorities reflected in this budget are those of the donor community or of the host country is unclear, but even where projects reflect local priorities the fact that they are financed from external sources influences their implementation. The generosity of the international donor community toward The Gambia has reinforced a frame of mind in which there is a natural progression from the identification of a need or bottleneck to the search for an external source of funds and expertise for its solution. Aid may not only replace local sources of investment funding but also reduce the local capacity for economic management. Nowhere is this syndrome more evident than in regard to technical assistance.

Diagnostic studies of parastatals and ministries invariably conclude that there is a need for additional technical assistance. The willingness of the donors to meet the needs thus identified has made the country increasingly dependent on it.[8] The PSD may be faulted for failing to address this issue. In fact its plea for an intensification of the external assistance effort could be viewed as a further manifestation of aid dependency.

5. Concluding Observations

The Gambia is among the poorest countries in the world. The recently-published UNDP Human Development Index, which takes account of health and educational indicators as well as income per person, placed The Gambia second from last out of a total of 164 countries in 1990. The growth in real income per capita averaged only about 1.5 per cent a year since the mid-1980s. Raising the living standards of the population is therefore a matter of urgency.

Under the ERP prudent macroeconomic policies halted the decline of the economy and restored the preconditions for economic growth. A central element of the PSD is the case for additional assistance as a means of accelerating the rate of growth. However, the level of foreign assistance to The Gambia is already among the highest in the world relative to GNP; in 1988 per capita aid was $103 relative to GNP per capita of $220.[9] No comprehensive evaluation of the effectiveness of existing aid is available, and there are grounds for skepticism about the claim that a lack of aid is a constraint on growth. The greatest challenge facing the economy during the period of the PSD is to demonstrate that the lessons of the previous five years have been internalized and to reverse the trend toward increasing dependence on aid and external economic management by increasing the effectiveness with which the available resources are used. Failure to do so will postpone the day when the country will be able to meet the challenge of providing an acceptable standard of living for its rapidly growing population.

Endnotes:

1. For example, the SAL-II Agreement concluded with the World Bank in 1989, contained a commitment to "preparing a medium-term public expenditure programme (PEP)". This was the latest expression of a series of commitments to budget reform. However, the interpretation of this condition became a bone of contention between the Bank and Gambian officials in 1991, contributing to the delay in the disbursement of the second tranche of the loan.

2. In 1990 The Gambia had ten active projects with the World Bank alone, involving a total of $100 million. The local professional capacity in areas such as financial control and engineering is hardly adequate to deal competently with the administrative demands of these projects. Furthermore some of the projects were poorly designed. As a result of these factors The Gambia's rating on the implementation of its World Bank project portfolio deteriorated sharply during 1989/90.

3. However USAID grants continue to be tied to meeting a number of conditions relating to further reforms of the financial sector.

4. GOTG 1990.

5. The GPMB has been managed by expatriate consultants since late 1991; the GCDB has been offered for sale and the first steps have been taken in the preparation of a management lease for the GUC.

6. World Bank 1989a:53.

7. Over the period 1986-90 the exchange-rate-adjusted returns to investment in three-month treasury bills in The Gambia matched those on comparable investments in the UK and far exceeded those in the US (see Walsh 1991).

8. According to the UNDP Development Coordination Report for 1989, there were over 300 full-time technical assistants working in the Gambian public sector. Several recent examples of the tendency for donors to increase the country's reliance on external technical assistance can be cited. Disagreement with the World Bank over what was entailed in the completion of a public expenditure program led to the funding by the UNDP of short-term consultancy in four ministries. During 1990-91 a major exercise was mounted by the UNDP to enhance indigenous capacity for economic management, the immediate result of which was a sizeable influx of short-term technical assistants, whose report in turn recommended a significant increase in the level of long-term assistance! In mid-1991 the local management of the GPMB was replaced by an expatriate team and it is planned to tackle the long-standing problems in the Gambia Utilities Corporation by leasing the company to an expatriate management team.

9. See Finance and Development, IMF, September 1990:9.

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Lessons from the ERP for Sub-Saharan Africa

Michael Roemer and Merilee S. Grindle

TO BE ADDED

Data Appendix

Appendix Table 1: The Gambia, Balance of Payments

(Millions of Dalasis)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Merchandise Trade	-2.5	-10.0	-59.3	-192.6	-144.4	-90.5	-91.2	-87.3	-108.6	-225.7	-213.1	-174.8	-316.5	-377.7
Exports (f.o.b.)	25.0	30.2	75.5	55.9	82.6	156.8	235.9	251.1	324.0	526.6	546.8	727.4	974.7	1126.4
of which: Groundnuts	24.0	28.8	69.5	30.9	33.8	62.8	76.2	65.5	52.8	45.0	68.6	120.8	135.6	122.2
Re-exports	0.8	1.0	2.5	15.0	40.7	85.9	152.4	178.5	277.6	436.7	525.2	560.9	776.0	939.2
Imports (f.o.b.)	-27.4	-40.2	-134.8	-248.5	-227.0	-247.3	-327.1	-338.4	-432.6	-752.3	-760.0	-902.2	-1291.2	-1504.1
Services (Net) & Private Transfers	-1.7	-6.6	-5.2	-50.0	-70.7	-66.0	-112.0	-68.9	-158.7	-147.7	-81.0	-82.3	-94.6	-57.3
Of which: Travel/Tourism	0.0	1.6	15.6	37.4	27.8	40.8	77.8	74.1	112.6	252.3	252.3	287.3	319.7	437.1
Private Transfers		-1.2	3.0	7.0	7.1	6.8	14.8			55.1	59.5	54.9	68.3	92.5
Current Account Balance	-4.2	-16.7	-64.6	-242.5	-215.1	-156.5	-203.2	-176.1	-267.3	-373.4	-294.1	-237.1	-423.[illegible]	-355.7
Capital Account Balance	7.0	11.3	3.9	109.0	81.4	-4.0	49.6	125.0	108.0	423.9	389.2	289.1	274.4	236.7
Official Loans & Transfers		2.5	6.3	127.8	147.5	99.9	137.2	135.7	132.5	373.[illegible]	370.3	299.2	469.0	417.3
Officials Transfers		3.6	1.4	63.5	105.8	68.6	100.4	114.7	157.5	341.3	311.8	295.5	360.7	351.3
Official Loans (net)		-1.1	4.8	64.3	41.8	31.3	36.7	20.9	-25.1	32.1	58.6	3.7	108.3	66.1
Gross Borrowing				65.3	53.3	49.5	63.9	49.2	36.0	111.0	128.8	91.5	114.6	104.6
Amortisation				-0.9	-11.6	-18.3	-27.1	-28.2	-61.1	-78.9	-70.3	-87.8	-103.0	-87.0
Private Capital (net)		8.8	-2.4	-18.8	-66.2	-103.9	-87.6	-10.6	-24.5	50.5	18.9	22.0	88.3	82.6
Long Term		4.6	2.5	4.5	14.9	8.4	3.2	3.1	40.3	45.9	22.5	22.0		
Short Term & Errors & Ommissions		4.2	-4.8	-23.3	-81.1	-112.3	-90.8	-13.7	-64.8	4.6	-3.6	-32.0	77.8	87.0
Overall Balance	2.8	-5.4	-60.7	-133.5	-133.7	-160.5	-153.6	-51.1	-159.3	50.4	95.1	32.0	211.4	232.3
Financing	-2.8	5.4	60.7	133.5	133.7	160.5	153.6	51.1	159.3	-50.4	-95.1	-32.0	-211.4	-232.3
IMF (net)			-4.4	21.4	19.6	19.2	3.2	-17.3	-49.8	48.6	27.0	32.9	38.9	-15.4
Purchases			0.0	21.4	22.2	25.4	11.1	0.0	0.0	102.8	64.9	62.2	71.5	37.4
Repurchases			0.0	0.0	-2.6	-6.2	-8.0	-17.3	-49.8	-54.1	-37.8	-29.3	-32.6	-52.9
Change in Reserves (increase -)			20.0	-63.4	37.9	-19.9	14.6	6.9	12.5	-88.1	-85.6	32.9	-94.6	-214.7
Change in Arrears (increase +)			0.0	62.9	-17.8	83.0	86.9	25.7	111.1	-266.1	-62.2	-106.1	-155.7	-2.2
Other			0.0	0.9	0.0	0.0	0.0	0.0	0.0	256.9	14.4	16.5	-155.6	-2.2

Sources: Trade Division of Ministry of Finance and Trade
Central Bank of The Gambia Quarterly Bulletins, various editions
International Monetary Fund, SM/92/111, June 2, 1992

Appendix Table 2: The Gambia, GDP by Industrial Origin

(Millions of Dalasis--Constant 1976/77 Prices)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
GDP in Agriculture	82.8	92.4	109.9	88.0	125.3	151.3	119.3	127.6	133.2	148.3	153.2	153.6	163.5	109.7
Groundnuts				21.5	38.9	54.1	40.7	37.5	27.1	39.5	42.9	35.2	47.7	26.7
Other Crops				45.3	50.6	59.8	40.1	49.4	66.2	58.3	58.5	65.4	61.6	45.7
Livestock				25.0	28.7	29.6	30.5	32.3	33.3	34.3	35.3	36.4	37.0	24.2
Forestry				2.0	2.0	2.1	2.2	2.3	2.4	2.4	2.5	2.6	2.7	3.0
Fishing				4.0	5.0	5.7	5.9	6.2	4.2	13.8	13.9	14.1	14.5	10.1
GDP in Industry	11.1	13.3	32.3	47.1	37.4	32.9	39.4	38.2	38.4	44.0	47.2	45.5	54.0	65.3
Manufacturing						19.3	25.5	23.8	23.8	26.3	27.8	25.6	30.8	32.1
Construction						12.0	12.4	13.1	13.1	16.1	17.7	18.3	21.6	30.1
Electricity & Water						1.6	1.5	1.3	1.5	1.6	1.5	1.6	1.6	3.1
GDP in Services	83.9	115.3	149.1	193.9	193.0	216.3	221.0	226.2	215.6	227.5	240.1	245.7	259.1	361.2
Wholesale/Retail Trade				77.5	76.1	90.6	87.8	91.7	85.5	87.4	92.4	86.8	97.3	147.1
Of which: Groundnut Mkting				12.7	23.2	36.2	26.4	13.0	13.9	23.8	25.0	14.8	21.1	9.5
Hotels & Restaurants				6.6	5.3	10.3	13.7	16.2	17.4	17.3	17.9	20.1	16.1	24.6
Transport & Communications				32.0	30.9	28.2	29.0	33.8	28.9	40.1	44.5	48.2	51.8	85.0
Bus. Services & Housing				23.3	24.2	25.7	26.4	25.5	24.5	26.3	27.7	29.3	30.3	33.0
Government Services				48.8	50.5	55.0	56.4	52.0	53.2	49.1	50.3	53.6	53.6	56.5
Other Services				5.8	6.0	6.5	7.7	7.0	6.0	7.2	7.4	7.7	8.0	15.0
GDP at Factor Cost	177.7	221.0	291.3	329.1	355.7	400.5	379.7	392.1	387.1	419.8	440.5	444.9	476.6	464.3
Net Indirect Taxes	14.1	20.4	32.2	31.2	36.8	41.7	42.3	43.1	46.9	37.8	42.3	59.2	58.4	71.9
GDP at Constant Market Prices	191.9	241.4	323.5	360.3	392.5	442.2	422.0	435.2	434.0	457.6	482.8	504.1	535.0	536.2
Implicit GDP Deflator	52.3	55.1	84.3	113.6	117.5	119.4	141.8	154.6	198.0	235.6	260.8	295.5	335.1	376.5

Sources: Central Bank of The Gambia Quarterly Bulletins, various editions

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Appendix Table 3: The Gambia, National Income, Savings and Investment

(Millions of Dalasis)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
GDP at Mkt Prices	100.3	133.0	272.9	409.4	461.4	527.9	598.5	672.7	859.3	1078.1	1259.3	1510.6	1793.0	2056.6
Exports of Gds & Non Fact. Services	25.0	31.8	91.1	93.3	110.3	197.6	313.7	325.2	436.6	778.9	799.1	1014.7	1357.8	1634.9
Imports of Gds & Non Fact. Services	-29.1	-42.6	-158.6	-290.9	-266.1	-286.7	-395.1	-388.6	-501.5	-972.5	-884.3	-1053.2	-1653.9	-1922.4
Resource Balance	-4.2	-10.8	-67.5	-197.6	-155.7	-89.1	-81.4	-63.3	-65.0	-93.6	-85.1	-38.4	-296.1	-287.5
Merchandise Exports	25.0	30.2	75.5	55.9	82.6	156.8	235.9	251.1	344.7	491.7	526.0	624.0	974.7	1126.4
Domestic Exports	24.2	29.2	73.0	40.9	41.9	70.9	83.5	72.6	67.2	55.0	100.8	86.9	197.7	187.2
Re-exports	0.8	1.0	2.5	15.0	40.7	85.9	152.4	178.5	277.6	436.7	425.2	537.1	776.0	939.2
Merchandise Imports (c.i.f.)	29.1	42.7	142.9	263.4	240.6	262.1	346.7	358.7	494.4	859.9	868.6	1055.9	1506.9	1804.7
Merchandise Trade Balance	-4.1	-12.5	-67.4	-207.5	-158.0	-105.3	-110.8	-107.6	-149.7	-368.2	-342.6	-432.0	-532.2	-678.3
Gross Domestic Expenditure	104.5	143.8	340.4	607.0	617.1	617.0	679.9	736.0	924.3	1171.7	1344.4	1549.0	2089.1	2344.1
Total Consumption	88.9	128.3	299.4	504.7	510.8	528.2	566.6	606.0	780.2	909.6	1106.8	1324.1	1765.5	2049.1
Private Consumption	78.6	105.9	260.8	428.1	392.5	433.4	463.4	498.9	668.1	749.5	834.5	1104.2	1466.9	1701.2
Government Consumption	10.3	22.4	38.6	76.6	118.2	94.9	103.3	107.1	112.1	160.1	272.3	220.0	298.6	347.9
Aggregate Investment	15.5	15.5	40.9	102.3	106.3	88.8	113.3	130.0	144.1	262.0	237.5	224.9	323.6	295.0
Government Investment	6.3	3.1	11.3	69.8	68.8	43.8	70.1	109.1	91.3	168.4	171.3	159.9	173.0	198.3
Private Investment	8.7	11.6	23.7	35.6	40.1	42.5	33.4	20.0	45.0	58.5	65.2	65.0	150.6	96.7
Change in Stocks	0.5	0.9	5.9	-3.1	-2.6	2.5	9.8	0.9	7.8	35.1	1.0	21.6	52.0	34.4

Sources: Ministry of Finance and Economic Affairs, Macro-Policy Analysis Unit, GDATA91 spreadsheet
International Monetary Fund, SM/92/111, June 2, 1992

Appendix Table 4: The Gambia, Monetary Survey

(Millions of Dalasis)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Net Foreign Assets	16.5	21.4	68.4	-48.5	-101.7	-160.9	-255.4	-254.8	-584.7	-313.2	-176.0	-149.8	-146.3	143.4
Monetary Authorities	13.6	23.9	58.4	-31.7	-93.7	-135.1	-237.5	-257.6	-595.4	-333.4	-192.1	-155.8	-166.9	115.1
Foreign Assets									11.4	97.7	255.8	232.4	281.9	553.3
Foreign Liabilities									-606.8	-431.1	-447.9	-388.2	-448.8	-438.2
Commercial Banks	2.9	-2.5	10.0	-16.8	-8.0	-25.8	-17.9	2.8	10.7	20.2	16.1	5.9	20.6	28.3
Net Domestic Assets										294.5	224.9	191.6	112.0	-67.2
Domestic Credit	-8.7	-0.2	32.3	210.3	241.8	331.2	370.2	377.8	501.3	326.0	256.2	241.9	174.5	58.1
Government (net)	-12.0	-9.3	-1.4	50.8	77.6	165.4	196.0	179.1	100.3	-64.9	-37.5	-115.2	-115.3	-279.4
Public Enterprises									217.4	216.7	101.4	132.5	39.3	47.8
of which: GPMB									132.8	156.0	56.0	75.1	28.1	37.7
Private Sector	3.3	9.1	33.7	159.4	164.1	165.8	174.1	198.6	183.6	174.2	192.3	224.5	250.5	289.8
Revaluation Account									237.4	392.8	392.2	433.5	590.3	564.4
SDR Allocation (D mil)	0.0	3.3	5.2	8.7	12.9	14.3	19.5	33.6	19.5	46.5	46.8	48.3	56.5	56.5
Money and Quasi-Money	9.9	14.0	51.9	86.2	98.6	132.5	137.0	182.5	227.4	327.3	394.3	427.0	499.5	584.1
Money (Cash & Demand Deps.)	8.3	11.0	34.4	56.6	58.6	80.0	77.1	96.5	129.5	192.4	222.1	235.2	282.0	334.3
Quasi-Money (S & T Deps.)	1.6	3.0	17.5	29.6	40.0	52.4	59.9	86.1	97.9	134.9	172.2	191.8	217.5	249.8
Other Items (net)	-2.1	7.2	48.9	75.6	41.5	37.8	-22.3	-59.6	-310.8	-314.5	-314.1	-334.9	-471.3	-427.7

Sources: Central Bank of The Gambia Quarterly Bulletins, various editions
International Monetary Fund, SM/92/111, June 2, 1992

Appendix Table 5: The Gambia, Central Government Operations

(Millions of Dalasis)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Revenue and Grants	20.8	26.9	47.9	104.2	148.1	121.6	153.4	180.0	274.9	479.8	494.7	575.7	659.6	678.5
Revenue	13.6	26.8	46.0	79.9	91.3	104.7	127.4	147.7	215.8	318.7	338.1	440.1	508.4	533.3
Direct Taxes	0.4	1.5	4.8	17.4	14.9	12.9	16.8	23.4	32.1	41.5	44.0	57.2	67.6	70.6
Taxes on Intern. Trade	8.7	12.5	31.6	48.4	60.0	73.5	91.1	97.4	147.3	239.6	242.4	228.6	217.1	235.2
Import Duty/Tax	8.0	2.1	27.1	47.3	55.8	72.6	79.2	89.0	138.1	233.8	225.7	220.3	217.0	234.4
Groundnut Export Tax	0.7	0.4	4.6	0.1	3.3	0.0	10.7	0.0	8.1	5.2	8.3	0.0	0.0	0.0
Domestic Taxes on G&S	0.0	0.4	1.0	3.7	4.0	4.7	6.7	14.2	13.1	18.3	23.1	125.0	171.4	214.2
Other Tax Revenue	0.1	0.2	0.0	0.5	0.6	0.7	1.1	1.6	1.6	0.7	0.9	0.6	1.1	1.2
Total Tax Revenue	9.2	14.5	37.4	70.1	79.4	91.8	115.5	136.6	194.1	300.2	310.4	398.4	457.2	521.2
Non-Tax Revenue	4.4	12.3	8.6	9.9	11.9	12.9	11.9	11.1	21.6	18.5	27.7	41.7	51.2	12.1
Grants	7.2	0.1	1.9	24.3	56.8	16.9	26.0	32.3	59.1	161.2	156.6	135.6	151.2	145.2
Expenditure and Net Lending	18.6	27.6	54.1	158.6	184.9	156.4	210.9	262.3	258.0	542.1	608.1	544.0	705.3	644.8
Current Expenditure	11.8	24.4	39.9	89.3	116.1	112.6	140.6	151.4	178.8	312.6	434.7	386.4	443.2	452.4
Personal Emoluments	5.5	7.9	10.6	33.7	41.1	48.0	50.2	53.3	56.4	57.3	61.6	100.2	133.3	144.8
Net Lending	0.5	0.1	2.9	-0.5	0.0	0.0	0.0	1.8	14.9	68.5	-2.7	-2.3	89.1	-3.4
Development Expenditure	6.3	3.1	11.3	69.8	68.8	43.8	70.3	109.1	64.3	161.0	176.1	159.9	173.0	198.3
Loan-Funded	6.0	0.4	2.3	67.8	62.6	24.7	45.0	62.2	36.6	110.0		92.2		
Grant-funded	0.3	0.1	1.0	0.0	0.0	19.4	26.0	32.3	16.3	35.2		48.5		
GLF	0.0	2.6	8.0	2.1	6.2	4.3	0.0	14.6	11.4	13.8		19.2		
Increase in Arrears			0.0	0.0	0.0	0.0	20.5	25.7	-35.0	-14.1	-5.4	-25.5	0.0	0.0
Surplus/Deficit (Cash Basis)														
Excluding Grants	-4.9	-0.8	-8.1	-78.7	-93.6	-51.6	-63.0	-89.0	-77.2	-237.6	-275.4	-129.4	-196.9	-111.5
Including Grants	2.2	-0.7	-6.2	-54.4	-36.8	-34.7	-37.0	-56.7	-18.1	-76.4	-118.8	6.3	-45.7	33.7
Financing	-2.2	0.7	6.2	54.4	36.8	34.7	37.0	56.7	18.1	76.4	118.8	-6.3	45.7	-33.7
Foreign (net)	-2.6	0.5	5.2	50.1	34.7	20.8	21.2	38.0	7.1	241.4	73.8	15.4	116.4	91.1
Domestic (net)	0.4	0.2	1.0	4.3	2.1	13.9	15.8	18.7	11.0	-165.0	44.0	-49.6	-75.4	-124.8
Banking System			-2.4	7.3	-1.7	13.2	5.4	14.5	20.4	-163.0	27.4	-77.7	-96.0	-164.1
Other			3.8	-3.3	3.7	0.0	10.2	5.8	23.7	6.3	20.1	31.6	20.6	44.3

Sources: Estimates of Recurrent Revenue and Expenditure, Republic of The Gambia, various editions
International Monetary Fund, Article IV tables
International Monetary Fund, SM/92/111, June 2, 1992

Appendix Table 6: The Gambia, Composition of Trade

(Millions of Dalasis)

	1965/66	1970/71	1975/76	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Merchandise Imports (c.i.f.)	29.1	42.7	142.9	263.4	240.6	262.1	346.7	358.7	494.4	859.9	868.6	1055.9	1506.9	1804.7
Food	4.0	7.8	30.1	63.8	74.9	65.6	127.1	113.3	149.9	253.4	249.2	326.6	454.3	559.8
Beverages/Tobacco	2.0	3.1	9.9	9.7	14.4	18.2	11.2	20.8	16.9	21.3	28.4	54.3	65.1	85.3
Crude Materials	0.7	1.3	3.5	6.0	4.7	4.3	4.9	4.4	6.6	9.2	7.6	10.4	14.4	14.0
Mineral Fuels	0.9	1.3	9.2	26.9	29.8	32.0	44.7	46.5	51.8	79.3	90.2	77.4	137.6	211.7
Animal/Vegetable Oil	0.0	0.0	0.3	2.1	0.6	2.5	3.3	5.1	3.0	26.4	14.4	16.2	23.3	38.1
Chemicals	1.8	2.9	10.0	14.0	16.7	18.1	15.4	20.7	29.8	64.3	61.7	74.4	107.5	103.5
Manufactured Goods	10.0	15.3	45.5	76.8	49.4	59.6	59.1	74.9	98.6	187.9	154.6	178.8	292.9	341.5
Machinery/Tport Equip.	5.9	6.3	22.0	50.2	33.0	37.6	57.4	52.3	88.0	160.4	191.2	228.0	284.3	291.3
Misc. Manufacturing	2.6	3.4	11.2	13.2	15.7	18.1	17.1	16.1	24.8	51.8	63.3	89.9	110.0	136.4
Other Imports	1.2	1.1	1.3	0.8	1.7	6.1	6.5	4.8	25.1	5.9	8.1	0.0	17.4	23.2
Domestic Exports -- Value	24.2	29.2	73.0	40.9	41.9	70.9	83.5	72.6	67.2	55.0	100.8	89.4	197.7	187.2
FAQ Groundnuts -- Volume ('000t)	32.5	30.6	50.8	11.0	27.2	49.3	25.3	19.2	11.6	9.9	21.4	9.3	8.1	10.5
FAQ Groundnuts -- Value	11.4	15.0	39.8	12.6	22.1	47.4	37.9	38.6	33.6	27.0	41.3	19.8	32.4	38.6
Groundnut Oil -- Volume	13.6	14.0	18.0	8.0	4.7	10.6	11.3	6.0	3.9	3.2	6.9	6.1	4.4	
Groundnut Oil -- Value	7.4	10.5	23.4	14.9	7.5	13.0	30.1	24.5	15.1	15.1	22.7	25.1	34.9	18.3
Groundnut Meal -- Volume	20.9	12.8	23.1	8.1	10.6	8.8	15.6	6.8	9.6	4.2	4.9	7.0	7.0	
Groundnut Meal -- Value	5.2	3.4	6.4	3.4	4.2	2.4	6.2	2.4	4.1	3.0	4.5	6.2	5.8	6.4
Fish -- Volume	0.5	0.8	11.5	10.6	9.2	5.0	5.8	4.2	0.8	0.6	3.8	1.2	1.7	
Fish -- Value	0.1	0.2	2.6	6.4	4.7	3.3	4.0	3.5	2.5	2.4	13.7	20.1	33.1	30.5
Hides & Skins -- Volume	0.0	0.1	0.1						32.8	36.1	30.5	35.0	56.1	
Hides & Skins -- Value	0.0	0.1	0.1						1.8	1.8	2.1	3.8	2.9	
Other Exports* -- Value	0.1	0.1	0.8	3.6	3.4	4.9	5.2	3.6	11.8	5.8	16.5	14.4	18.5	19.4

Sources: Central Statistics Department, The Gambia
Central Bank of The Gambia Quarterly Bulletin, various editions
Trade division of Ministry of Finance and Trade, The Gambia

* "Other" catergory excludes re-exports

Appendix Table 7: The Gambia, Interest Rates

	Central Bank		Commercial Banks		Deposit Rates				
Year	Discount Rate 1/	Crop Advance	Short Term Advances	Crop Finance	Savings Bank	Time Deposits 6-month	Time Deposits 12-month	Treasury Bills	Inflation Rate 2/
1970	--	--	--	7-8	3-4	2	3		-2.4
1975	6	6	7-12	7.5-8	3.5	4	6		29.6
1980	8	6	10-15	8.5	6-6.5	6.5-7.5	8-9		1.3
1981	9.5	9	15-17	10-18	8-8.5	9-10.5	12	8	7.6
1982	9.5	8	15-17	10-18	8-8.5	9-10.5	12	8	3.4
1983	9.5	8	12-18	9-18	6-8.5	7.5-10.5	10-12	8	1.6
1984	9.5	8	15-18	9-10	7-10.5	9-12.5	13.5-14.5	8	18.8
1985	15	15	18-27	15-27	15	16	16	15	9.0
1986	20	17	18-30	10-24	17-18	18-19	19-20	19	28.1
1987	21	18	9-29	10-21	15	15-15.5	16-17	20	19.0
1988	18	15	9-28.5	9-29	12.5-15	12.5-13.5	13.5-19	17	10.7
1989	19	16	9-26.5	9-25	12.5	12.5-13.5	13.5-19	18	13.3
1990	19.5	16.5	22.5-26.5	20-26.5	12.5	12.5-13.5	13.5-15.5	18.5	13.4
1991	18.5	--	23.5-26.5	23.5-26.5	12.5	12.5-13.5	13.5-15.5	17.5	12.3

1/ On commercial paper
2/ Period average

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Biographies

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James S. Duesenberry is the William Joseph Maier Professor of Money and Banking Emeritus, in the Department of Economics at Harvard University. As an HIID consultant in The Gambia, Duesenberry advised on monetary policy, exchange rate policy, interest rate policy, and central bank independence. He received a Ph.D. in economics from the University of Michigan.

Clive S. Gray is an Institute Fellow at HIID and served most recently as Senior Advisor for HIID's Pricing Policy Project in Morocco. In The Gambia, Gray worked on tax reform, computerization, and debt management. In 1983, Gray conducted a study for USAID/Banjul that led to the government's undertaking of Economic and Financial Policy Analyses Project in 1985. He received his Ph.D. in economics from Harvard University.

Merilee S. Grindle, a research associate at HIID, is also lecturer in public policy and faculty advisor to the Edward S. Mason Program in Public Policy and Management. She is a specialist on the comparative analysis of policymaking, implementation, and public management in developing countries. Grindle earned a Ph.D. in political science from M.I.T.

Richard M. Hook, former Research Associate at HIID, and now an independent consultant specializing in financial management. In The Gambia, Hook worked on parastatal reform and privatization. Hook has an MBA from Amos Tuck School of Business and has done graduate work at Harvard University.

Deborah A. Hoover is former Executive Director of the Council on the Arts at MIT, and currently a private consultant specializing in management of non-profit agencies. She was Administrative Consultant to the EFPA project with responsibility for training, finance and general administration. Hoover holds a Masters degree from Cambridge University.

Christine Jones is a former Institute Associate at HIID. She is currently a Country Economist with The World Bank. Jones has worked in the area of rural development, women in development, and agricultural marketing. In The Gambia, she studied groundnut pricing and marketing. She holds a Ph.D. from Harvard University.

Richard D. Mallon is an Institute Fellow at HIID and a Lecturer on Economics at Harvard University. His expertise is in national development planning, structural adjustment and stabilization policies, trade and industrial policy reforms, and the reform and privatization of state-owned enterprises. In The Gambia, he advised on privatization and parastatal reform and conducted workshops on these topics. Mallon received a Ph.D. in economics from Harvard University.

Catherine J. McAuliffe joined the IMF under the Economist Program and is now in the Africa Department. As a consultant to the EFPA project, she worked on the rationalization of domestic debt, the monitoring of the IMF/World Bank programs and customs reform. McAuliffe received her Masters degree from the Fletcher School of Law and Diplomacy where she is currently a PhD candidate.

Paul E. McNamara is a former Project Assistant in the EFPA project in The Gambia. In that capacity, he worked on debt management and customs reform issues, and the computerization of the budget. He was also a member of a special committee in 1988 that reviewed the customs administration. McNamara is currently a doctoral candidate in applied economics at the University of Minnesota.

Malcolm F. McPherson is a Research Associate at HIID and served as Senior Advisor for the EFPA project in The Gambia. McPherson first studied the Gambian economy in 1979, as part of the Sahel recurrent cost study. He has been closely associated with the country's economic reform efforts. As the technical advisor/economist for the EFPA project, he focused on helping the government to implement the reform measures contained in the ERP. McPherson has a Ph.D. in economics from Harvard University.

Dwight H. Perkins, director of HIID and faculty fellow, is the Harold Hitchings Burbank Professor of Political Economy at Harvard. His is the author, co-author, or editor of nine books and over fifty articles, most dealing with the economic development of China, Korea, and other parts of Asia. Professor Perkins received a Ph.D. in economics from Harvard.

Steven C. Radelet is an Institute Associate at HIID and currently Resident Advisor for the Customs and Economic Management Project in Indonesia. He specializes in stabilization, structural adjustment, and debt issues. He served as Project Assistant and Project Associate in The Gambia for HIID, where he conducted economic and financial policy analyses for the ministry of finance. He monitored the IMF structural adjustment program and helped to computerize The Gambia's debt reporting system. Radelet holds a Ph.D. in public policy from Harvard University.

Michael Roemer, an Institute Fellow at HIID. is also Senior Lecturer in Economics at Harvard University and serves as Cambridge Coordinator for the Indonesia Projects. He specializes in macroeconomic reform, trade, and industrial policy. A former Executive Director of HIID, Roemer recently helped The Gambia begin developing an industrial policy. Roemer holds a Ph.D. in economics from MIT.

Parker Shipton is an Institute Associate at HIID as well as a lecturer on anthropology at Harvard. His research interests include agrarian systems, land tenure, rural finance, small-scale enterprise, and social anthropology at Harvard and at Cambridge University. He has served as a consultant to the World Bank, assessing the impact of the Integrated Agricultural Development Project and the Smallholder Production Services and Credit Project. Shipton earned his Ph.D. in social anthropology at Cambridge University.

Brendan M. Walsh is the former Project Director and long-term technical advisor/economist for the EFPA project. In The Gambia, he worked on macropolicy reform. He was a major contributor to the development of the Program for Sustained Development which succeeded the ERP. He is currently Professor of National and Applied Economics at University College, Dublin. Walsh holds a Ph.D. degree from Boston College.