Agency for International Development
Mission to Senegal

Senegal's Reform and Development Program and the Impact of U.S. Assistance

Dakar
March 14, 1988
4549P

TABLE OF CONTENTS

I. Executive Summary

In 1984, Senegal was close to economic collapse. Over the intervening four years since then, stabilization and structural adjustment efforts by the GOS with assistance from the donors have turned the situation around. Since 1984, the GOS has initiated a wide range of courageous policy reforms in agriculture, industry, governmental organization, and government finance. The momentum of reform is being maintained and we are now in a period of serious implementation of the reform package. Progress is being made and the results are positive, but the Senegalese economy still has a long way to go before it will achieve self-sustaining growth.

Agriculture was given priority in the GOS's reform and recovery programs with formulation of the New Agricultural Policy in 1984 and the Cereals Plan in 1986. Food security objectives are to be met by improvements in rainfed agriculture and development of the potential for irrigated agriculture in the Senegal River Valley in the post-dam period.

Senegal's medium term growth potential still lies primarily in agriculture, through (a) the introduction of improved cereals varieties, management practices and production systems, (b) expanded but rational use of fertilizer and other yield enhancing technology in rainfed agriculture in the southern part of the peanut basin and in Casamance, (c) the development and application of improved water management and production technology for the Senegal River Valley, and (d) the development of extensive tree cropping. The growth potential of the urban economy lies partly in development of an internationally competitive industrial sector (which is a longer-term bet in view of current constraints such as the labor code and the overvalued CFAF) and partly in the development and improvement of services, including tourism.

USAID/Senegal's strategy for the short and medium term focuses on the development of a diversified market economy. In agriculture it aims to encourage cereals production and the production of complementary commodities. Peanut pricing and fertilizer marketing are pressing parts of our continuing policy dialogue with the GOS. Reinforcing this central focus on agriculture is an emphasis on environmental problems and on soils and natural resource management through our reforestation and water management projects.

The key to private sector expansion and agro-industrial growth in the near term is banking sector reform. Our AEPRP-II will focus on better bank management, tighter bank supervision and control, and privatization of commercial banks in order to reduce government interference in lending decisions of the commercial banks. We intend to follow-up reform of the direct tax component of the GOS General Tax Code, which we are working on under AEPRP-I, with technical assistance on improvement of tax administration from the U.S. Internal Revenue Service and from the high level tax experts who are already contributing to our current efforts. This will broaden the tax base and reduce distortions in fiscal policy, which discourage private sector investment.

As part of bringing population into balance with Senegal's resources we will focus on child survival, extension and improvement of a national primary health care system, AIDS, population policy, and provision of services.

Senegal's urban employment problem is a major concern. Our interventions can be only indirect: through demonstrating the viability and therefore replicability of our Kaolack Community Enterprise and Development project; through support to artisanal and semi-industrial food processing in rural areas and secondary cities; and through private sector training.

II. The Crisis Situation in 1984 (1983/84)

Senegal's situation four years ago was marked by awareness within the GOS and among the donors of economic crisis, of the inability of the GOS to cope with its financial obligations unless it adopted major changes in economic policy and received significant volumes of external assistance. Intervention of the donor community consequently took two forms: an active policy dialogue, and increased aid flows, especially non-project aid.

Senegalese agriculture in 1983/1984 was suffering from the effects of a series of severe droughts, inefficiencies of the agricultural parastatals that had been built up with enthusiastic donor assistance in the 1970s, and an administered price structure that biased the terms of trade against agriculture. Crops suffered severely from drought in three of the five agricultural seasons from 1979/80 through 1983/84. The 1979/80 drought led to the collapse in 1980 of ONCAD, the agricultural credit and marketing institution dealing primarily with peanuts, and a rapid increase in imports of rice while wheat imports leveled off at 100,000 MT per year. The collapse of ONCAD disorganized and demoralized the agricultural production and trading system. It also saddled the banking system with a consolidated debt of CFAF 100 billion. The seed stock function of ONCAD was transferred to SONAR, a new temporary parastatal that was abolished on schedule in 1984.

The GOS Treasury was in severe difficulty with heavy deficits because of expanding salary and other expenditures on current account, heavy consumer subsidies on rice, cooking oil, wheat flour, and petroleum products, and deficits of the parastatals. In addition, major subsidies were being paid to the peanut oil crushing mills, the sugar company (CCS), and the cotton parastatal. Aside from the ONCAD debt, the GOS had built up heavy arrears on domestic and foreign debt.

Foreign trade deficits were out of control: on the imports side because of Senegal's heavy reliance on food imports, the OPEC oil price increases, and a rapid rise in the value of the dollar against the CFAF from 1980 to 1983; and on the exports side because of the decline in the world price of Senegal's phosphate exports, declines in the world price for peanuts, and fluctuations in the volume of Senegal's peanut crop. The balance of payments deficit was aggravated by the increased CFAF cost of dollar-denominated external debt.

The crisis had already led to the realization by the GOS of the need for stabilization measures, but further deterioration of the economic situation led to cancellation in 1983 of both the IMF standby agreement (which had already replaced a 1980 IMF extended fund facility) and the second tranche of the World Bank's first structural adjustment loan (SAL) of 1980. In 1984, the crisis led to the formulation of the current package of structural adjustment measures.

III. GOS Plans for Adjustment and Growth

The economic difficulties of the late 1970's led Prime Minister Abdou Diouf to submit a recovery plan (Plan de Redressement) to the National Assembly in 1979; however, implementation was spotty and had little impact. In 1980, as the crisis intensified and ONCAD collapsed, President Senghor resigned and named Abdou Diouf President. The stabilization measures called for by the Plan de Redressement included reduction in consumer subsidies, reduction in agricultural debt, and restraint on the growth of the public sector.

The crisis of 1983 led first to formulation of the New Agricultural Policy (NAP) announced in April 1984. The major structural adjustment component of the policy package for agriculture was reducing the role of the regional rural development agencies. In addition, the NAP called for increasing efficiency in the supply of inputs to agriculture, new production strategies, and more financing for rural development.

In December 1984, the GOS presented to the first Senegal Consultative Group meeting in Paris a Medium and Long Term Recovery Program as the basis for the World Bank's second structural adjustment loan (SAL-II) and other donor support to GOS structural adjustment efforts. The main lines of the program were improvement of fiscal performance and public sector management, improvement and reorientation of the public investment program, and improvements in incentives for growth in production with a heavy accent on stimulating the private sector.

The Cereals Plan (June 1986), as drafted by the GOS Ministry of Rural Development, defined a strategy for local cereals development that takes account of both rainfed and irrigated agriculture. It deals with: (a) the infrastructure (e.g. irrigation) and agricultural research needs for expanding cereals production; (b) the credit, seed, and fertiliser requirements for intensifying production; and (c) the marketing, storage, and transformation aspects of channeling production to consumption. The Preamble to the Cereals Plan, drafted by the GOS Presidency (and the responsible World Bank agricultural economist), set cereals production into a policy context that deals with balance of payments and price policy as well as the specific question of rice imports.

The objectives of the Cereals Plan are to achieve 80 percent food self-sufficiency by the year 2000 based on increased domestic production of millet, sorghum and maize by 3.3 percent per year and of rice by 13.3 percent per year; and to support farmer self-reliance and income. Attainment of this objective requires: the continued freedom of movement and marketing of cereals throughout Senegal; encouragement of private sector involvement in the marketing of seed, fertilizer and other inputs to agriculture and the marketing of agricultural outputs; maintenance of an incentive floor price for Senegalese production of cereals, and protection for local production in the form of a tax on imported rice; expansion ano intensification of rainfed areas in the South and Southeast where rainfall is higest; intensification of irrigated farming at an average of 5,000 ha per year of new irrigation development; local cereals processing and transformation on an artisanal and semi-industrial scale; and increased assumption of responsibility by producers in farming operations.

The New Industrial Policy (NIP), announced in February 1987, recognized the futility and economic cost of an industrial import-substitution policy based on protection from the international market and the establishment of domestic monopolies and called for a reduction in protection. It also called for relaxation of the constraints of the labor code on hiring and firing, as well as for development of a program for applied research and for increased financing (from abroad) for industrial development. Reduction of import tariffs and rationalization of the tariff structure were initiated in 1986.

The Policy Framework Paper (PFP), whose preparation is a requirement for access to the IMF's structural adjustment facility, has now had two editions, the first in September 1986 and an up-dated revision in September 1987. The PFP provides the grand summary of structural adjustment measures, targets, and conditionality agreed to by the GOS and the IMF and IBRD. It is of even wider scope than the Development Policy Letters that accompany the World Bank's SALs. The PFP covers agricultural policy reform, industrial policy reform, energy policy, GOS public investment programing, parapublic sector reform, fiscal policy, credit policy, and external debt management. The areas of overlap of the PFP with USAID's most direct concerns are agricultural policy reform and the fiscal aspects of industrial reform. (See attached copy of the summary and time frame for macroeconomic and structural policies from the September 1987 PFP.)

IV. Accomplishments and Impacts, 1984-1987

In dealing with Senegal's economic crisis, the GOS and the major donors focused first, along IMF lines, on stabilization, using the financial symptoms of disequilibrium such as the government budget deficit, government arrears, the balance of payments deficit, credit expansion, and price inflation as indicators. The second line of attack was a set of managed structural adjustment measures needed for continued financial stability, economic growth, and the recovery and improvement of living standards. The alternative to managed adjustment would have been forced adjustment brought on by foreign exchange shortages and fiscal insolvency. Senegal has succeeded in stabilizing the economy, has managed the adjustment process, and is resuming growth at a respectable rate. (See economic indicators table.)

Senegal: Economic Indicators, 1984-1987

Indicator	CY 1984 or 1983/84	CY 1987 or 1986/87	Growth rate (%) 1/
A. Calendar year data:			
		(billions of CFAF)	
GDP in current prices	1,015.5	1,393.1	11.1
Consumption	964.9	1,293.2	10.2
Households	758.1	1,058.1	11.8
Government	206.8	235.1	4.4
Savings	50.6	99.9	25.4
		(percent)	
Savings divided by GDP	5.0	7.2	xx
		(billions of CFAF)	
GDP in 1987 prices	537.5	608.8	4.2
		(percent)	
Inflation rate 2/	13.3	3.0	xx
		(index)	
GDP in constant prices	100.0	113.3	4.2
Agriculture	100.0	164.3	18.0
Industry	100.0	116.1	5.1
B. Agricultural or fiscal year data:			
Agricultural production:		('000 MT)	
Millet-sorghum	332.0	633.8	24.0
Peanuts	570.9	821.8	12.9
GOS Budget:		(billions of CFAF)	
Revenues and non capital grants	195.6	257.1	9.5
Revenues	189.4	251.0	9.8
Tax revenues	177.4	196.0	3.4
Non-tax revenues	12.0	55.0	66.1
Grants (non-capital)	6.2	6.1	-1.0
Expenditure	205.3	232.7	4.3
Wages and salaries	100.4	119.8	6.1
Interest due on public debt	36.9	39.6	2.4
Other	68.0	73.3	2.5
Balance on current operations	-10.4	9.4	xx
Balance of payments:		(millions of $)	
Exports, f.o.b.	618.5	748.9	6.6
Imports, f.o.b.	862.7	983.3	4.4
Trade balance	-244.2	-234.4	-1.4
Current account balance	-260.8	-239.9	-3.6

xx Not applicable

1/ Three year average annual growth rate, 1983/84 to 1986/87 or CY 1984 to CY 1987.

2/ Using GDP price deflator.

A. Stabilization

The stabilization actions taken by the GOS have been relatively successful, as indicated by the fact that the performance criteria of each of the IMF standby agreements since 1983/84 have been met. These actions were by their nature restrictive and, at the time they were taken, required considerable political courage on the part of the GOS. One key decision that was taken after months of anguish and worry was to raise the consumer price of rice and to eliminate the subsidy on that essential commodity in the urban consumption basket. Other consumer subsidies were also abolished. The subsidy on gasoline and other petroleum products had already been eliminated in 1981/82 and replaced by a tax (now a value added tax). The subsidy on wheat was wiped out in 1984 and the millers now pay a considerable positive perequation on wheat imports. The subsidy on domestic peanut oil and imported vegetable oil was eliminated in 1985. The subsidy on imported rice was removed in three stages. In February 1982, the rice price was raised from CFAF 80/kg to CFAF 105/kg and generated a positive perequation for the CPSP. By 1983 the perequation was again negative. In the summer of 1983, the rice price was increased to CFAF 130/kg which brought the perequation into equilibrium. In January 1985, the price was raised to its present level of CFAF 160/kg just as the world price for rice dropped and turned the perequation heavily positive.

The balance on GOS current budget operations as recorded in the Ministry of Finance-IMF fiscal operations table (TOF) went from a deficit of CFAF 10.4 billion in 1983/84 to a surplus of CFAF 9.4 billion in 1986/87, by dint of containing expenditures and raising revenues. On the expenditure side, a tight squeeze was put on hiring of new personnel and on pay raises for existing personnel so that the government wage bill increased by only 6.1 percent per year from 1983/84 to 1986/87. Interest on the external public debt was contained by debt rescheduling. Other expenditures were cut back through 1985/86 and rose only in 1986/87. On the receipts side, tax revenues rose sharply in 1984/85, faltered in 1985/86, and continued their rise in 1986/87. The increase in 1986/87 came about following the first round of import tariff rate reductions that are part of the New Industrial Policy; customs receipts increased despite (or perhaps because of) the decrease in tariff rates. Non-tax revenues increased several fold as the GOS Treasury profited from the windfall of world price declines for petroleum, rice, and wheat. Grants received showed a steady increase.

Reduction in both internal and external arrears has been one of the performance criteria under the IMF standby. The annual reduction in arrears was raised steadily from CFAF 2.0 billion in 1983/84 to CFAF 14.0 billion in 1986/87.

The balance of payments deficit on current account reached a peak of $281 million in 1984/85 following the 1984 drought but declined to $240 million in 1986/87 as world prices for petroleum, rice, and wheat fell and the exchange rate for the U.S. dollar declined. The value of imports was held down by these price declines. Unfortunately, the value of Senegal's exports of peanut products also was held down, in their case by the decline in the world price of vegetable oil.

A credit squeeze was imposed under the IMF performance criteria and credit ceilings have been applied (with varying intensity) by the BCEAO. Between June 1984 and June 1987, private sector credit has grown in nominal terms by5.3 percent a year while inflation as measured by the consumer price index has averaged some 7.6 percent. As a result, private sector credit has declined in real terms by about 6 percent over the last three years.

Internal demand of the urban population has been constrained by the perequation tax on rice, abolition of other consumer subsidies, reductions in the public deficit, credit restrictions, and the stagnation of formal sector employment. Rice imports have declined despite the population increase. Combined with the effects of the fall in the exchange rate of the U.S. dollar, the constraints on demand have resulted in a progressive fall in the rate of increase in internal prices as measured by the consumer price index from 14 percent in 1983/84 to a preliminary figure of 0.4 percent in 1986/87. The reduction in the rate of internal price inflation has raised the real interest rate correspondingly, and rates are now strongly positive for both borrowers and savers.

Under strong donor pressure the GOS also is trying to rationalize the operations of SONACOS and the CSS.

B. Structural Adjustment

The GOS has undertaken and is actively implementing a wide range of the structural adjustment measures formulated since 1980 and set out in the policy statements cited in section III above. The USAID Mission has been concerned mostly with those related to agriculture: reducing the role of the GOS and its parastatals and encouraging the private sector to take over the functions relinquished by them; reducing subsidies on inputs to agriculture; and implementing the GOS cereals plan. We have been concerned with the basic structural adjustment measure for industry, namely reduction in protection, as well as with improved fiscal performance of agro-industry. We have also been intrumental in cleaning up the operations of the Price Perequation and Stabilization Fund (CPSP).

1. Structural adjustment in agriculture

Under the direction of President Abdou Diouf, the GOS has been taken serious steps to reduce the role of the government and the parastatals in agriculture.

The central features of cereals policy (deregulation of marketing and price stabilization interventions for millet-sorghum and maize) are being implemented. Prior to 1985, inter-regional movement of coarse grains was prohibited and the prohibition was sporadically enforced by the Economic Police; in 1985, all government restrictions on movement of local cereals within Senegal by private sector traders were abolished. The floor price, which is supported by purchases of grain by the Commissariat for Food Security (CSA) with funds provided by the donors, has been maintained with some success since inception of the system during the 1986/87 agricultural campaign.

Market prices for coarse grains have fluctuated seasonally with prices holding mostly above CFAF 60/kg (as compared with a floor price of CFAF 70/kg) for most of the year. The floor price support mechanism, despite the CSA's uneven administration, appears to have had a generally positive effect in sustaining the level of cereals prices and in moderating downward pressures on prices immediately after the harvest.

The GOS is now committed to restructuring the CSA to enable it to perform two tasks efficiently. The first is the receipt and transport of grant food aid for free distribution. The second is management of the cereals price support mechanism, including the handling of intra-year stocks of cereals. USAID/Senegal contracted with Price Waterhouse in August 1987 to prepare a plan, for use by the Common Fund and the GOS, to restructure an autonomous and streamlined CSA. The plan includes a series of management and administrative training seminars.

The activities of SODEVA and the other rural development agencies (SAED, SOMIVAC and SODAGRI) are constrained by annual contract-plans or lettres de mission that progressively diminish their scope. USAID and the other donors have been directly involved in discussions of SAED's third lettre de mission which sets the terms for reducing SAED's activities in the Senegal River Valley in the fields of credit, input supply, and rice milling. Efforts are being made to reform the operations of SONACOS, which was given responsibility for the all operations concerning the peanut crop after the abolition of SONAR in 1984. Over 2,000 persons have been laid off from the parastatals since 1984.

GOS subsidies on inputs to agriculture have been sharply reduced. Subsidies to fertilizer are no longer directly financed out of the GOS Treasury's own resources and the USAID-financed subsidy for fertilizer sold for cash has been progressively reduced over the past three years and will be zero as of January 1989. The fertilizer subsidy has not been available for fertilizer provided to farmers by the rural development agencies on credit since 1985. The GOS has also ended the distribution of peanut seeds on credit, obliging the farmers to pay cash for their peanut seed requirements or to retain their own seed from the previous crop, which they have done for the 1987/88 agricultural campaign.

On other aspects of the cereals plan, progress has been halting. Rice policy with respect to pricing, imports, and local production is still not internally consistent, and its clarification is one of the aims of ESF-VI. The GOS experiment with partial privatization of the rice import trade in the spring of 1987 was not successful for a variety of reasons and was called off until 1989 at the urging of the donors. One of the reasons for which the donors felt less urgency about pressing immediate privatization of the rice import trade is that the CPSP's operations have been considerably cleaned up; the CPSP is now, for example, much more energetic about collecting its bills from rice wholesalers than it was several years ago. The CPSP is now running surpluses where in 1984 it showed a deficit of over CFAF 20 billion. Because of positive perequation on imports of rice and wheat, the CPSP is now a net contributor to the Treasury rather than a drain.

The impact of the structural adjustment measures taken in agriculture so far has clearly been positive. Deregulation of cereals marketing and maintenance of the floor price, combined with satisfactory levels of rainfall, have resulted in high levels of production of millet and sorghum in the three successive crop years 1985/86-1987/88, as shown below (in '000 MT):

Crop	1983/84	1984/85	1985/86	1986/87	Projected 1987/88
Millet/sorghum	351.8	471.5	953.7	633.7	801.3
Maize	60.6	103.0	148.1	107.9	113.6
Cowpeas	12.9	15.2	74.4	54.9	28.6
Total coarse grains	425.3	589.7	1,176.2	796.5	943.5

Reduction in the fertilizer subsidy has had no measurable effect on production. Although fertilizer use is down by between 25,000 and 30,000 MTs since the early 1980's, other factors are clearly involved including higher world fertilizer prices, changes in agricultural credit systems, and changes in input delivery mechanisms. Any connection with changes in agricultural production are even more difficult to discern. The impact of 25,000 MT of fertilizer on Senegal's overall agricultural production would in any case be minimal, and these effects have been completely overshadowed by the large scale changes in rainfall which Senegal has witnessed in the past few years. The unsustainable drain on the Treasury of past fertilizer subsidies has now ended, and fertilizer use is being rationalized by the elimination of price distortions caused by subsidies.

2. Structural adjustment in industry

The New Industrial Policy included two major actions: reduction in protection by lowering tariffs and removing quantitative restrictions; and relaxation of the labor code. The schedule for all the steps in reduction of protection to date has been met. (These were among the conditions precedent for release of the first two tranches of the Senegal AEPRP cash transfer.) However the parliamentary bill containing the proposed revision of the labor code, which was a condition of World Bank SAL-II, met with stiff resistance from the labor unions and was watered down by the National Assembly. A third major element of the New Industrial Policy, namely investment to restructure potentially viable enterprises directly menaced by loss of protection, is dependent on external financing, some of which is to be obtained under the proposed IBRD industrial sector restructuring project. So far, industrial growth has not responded to the reforms.

The expected immediate impact of the reduction in protection was to put some of the existing formal sector industrial enterprises in difficulty. We do not yet have any direct information on enterprises that have been affected. The Boston Consulting Group study of 1987 indicated that potential negative effects of the New Industrial Policy should be manageable and limited, and that some of the industrial sub-branches will in fact benefit from the rationalization of tariffs and the consequent lowering of input costs. However, maintaining viability of some of the affected sub-branches will require reductions in redundant personnel and some new investment.

The GOS has announced privatization of 10 public sector enterprises, but so far has had little success in finding buyers. None of the enterprises proposed for privatization to date is in manufacturing.

C. Overall and Sectoral Growth

The crisis of 1983 was intensified by the drought of that year which resulted in a sharp fall in agricultural production in 1983/84; overall agriculture production as measured by value added in agriculture in constant price terms fell by almost 40 percent from CY1983 to CY1984. Industry including peanut processing stagnated, with a decrease in peanut oil pressing offsetting an increase in the rest of manufacturing industry. The gross domestic product (GDP) fell by 4.6 percent in constant prices.

Agricultural policy reforms combined with generally good rainfall resulted in respectable growth from CY 1984 to CY 1987. Value added in agriculture in constant price terms recovered almost to its CY 1983 level. Value added in industry grew by 5.1 percent per year and GDP by 4.2 percent per year over the 3-year period.

In agriculture, millet/sorghum production, which had fallen to 350,000 MT in 1983/84 recovered moderately in 1984/85 and reached 950,000 MT in 1985/86. In 1986/87, millet/sorghum production fell back to 630,000 MT partly as a result of rainfall patterns and partly because farmers' granaries had been replenished by the bumper crop of 1985/86. Peanut production, which had fallen from over 1.1 million MT in 1982/83 to 570,000 MT in 1983/84 and to 500,000 MT in 1984/85, recovered to 590,000 MT in 1985/86 and then jumped to 820,000 MT in 1986/87. The 1987/88 crop year has seen a further increase in production of both millet/sorghum (to 800,000 MT) and peanuts (to 960,000 MT). A major increase in rural incomes has been generated by those production increases and by favorable administered prices.

D. Living Standards and Employment

The new economic policies were consciously designed to reverse the previous bias in favor of urban workers and urban consumers, which entailed heavy subsidies for consumers, and taxation of agriculture through the fixing of low procurement prices for cereals and peanuts by the GOS. The price structure is now favorable to agricultural producers and unfavorable to urban consumers. Rice, which is mainly an urban consumption item, is now heavily taxed through the CPSP while a floor procurement price for millet and other coarse grains is supported by the GOS (with donor financing) through the Commissariat for Food Security. The peanut procurement price at CFAF 90 per kg (see below) is now generating a heavy deficit for SONACOS (financed largely by STABEX).

Prices: peanuts, millet and rice
(CFAF/kg)

Commodity	1983/84	1984/85	1985/86	1986/87	1987/88
1. Peanut procurement price:					
a. Gross	70.0	80.0	90.0	90.0	90.0
b. less Retention	-20.0	-20.0	-	-	-
c. Net	50.0	60.0	90.0	90.0	90.0
2. Coarse grains (millet, sorghum and maize) procurement price:					
a. Official fixed price	55.0	60.0	70.0	xx	xx
b. Official floor price	xx	xx	xx	70.0	70.0
3. Rice: consumer price for broken rice	130.0	160.0	160.0	160.0	160.0

As a result of these changes in administered prices and of increases in agricultural production, the most striking impact of the new economic policies and structural adjustment on living standards so far has been an improvement in agricultural incomes and rural consumption and a deterioration in urban living standards. The increases in rural incomes have also gone into a partial recapitalization of agriculture through building up of seed stocks as well as food stocks, acquisition of agricultural implements and consumer goods, and rebuilding of livestock herds. Rural employment has increased with the good crop both in agriculture and in the artisanal activities servicing and providing inputs to agriculture, and processing and transporting agricultural outputs.

Urban living standards have been reduced by the constraints on expansion of government employment and sluggish growth in non-government formal sector employment in the face of a rapidly growing labor force. Informal sector activities and the underground economy compensate in part for the lack of formal sector expansion; but youth unemployment is widespread and growing. The expansion of the urban economy that should follow from structural adjustment is still in the future.

V. U.S. Contributions

USAID/Senegal has contributed to Senegal's adjustment and growth directly through policy analyses and recommendations, policy-conditioned budget support, and projects that have helped the GOS formulate and implement some of its key policy reforms.

Much of the the intellectual ground for the New Agricultural Policy was turned during preparation of USAID/Senegal's Agriculture Sector Policy Analysis (Abt Report). The Abt report also was the basic analysis both for USAID/Senegal's participation in the policy dialogue on agriculture and for our Agricultural Production Support (APS) project (685-0269).

The policy dialogue on agriculture is carried out with three interlocutors on the GOS side: the Ministry of Rural Development, the Ministry of Finance, and the Presidency. The issues of cereals policy, fertilizer use, reducing the scope of the agricultural parastatals, and reducing agriculture sector deficits have been and continue to be the focus of our non-project portfolio: the ESF structural adjustment grants and the self-help measures of PL 480 Title I concessional sales. The financial support provided to the GOS by our ESF grants and PL 480 Title I loans takes the form of straight budget support. Conditionality attached to both instruments played a large role in reinforcing the GOS's decisions to abolish restrictions on cereals marketing, and to change the pricing system for cereals from a compulsory (and ineffectual) fixed price (sometimes enforced by the Economic Police) to the current floor price intended to support incentives to farmers without coercion. The policy dialogue on agricultural research issues, privatization of input marketing, irrigation and water control, and forestry policy have been and continue to be concerns of our project portfolio: Agricultural Research and Planning (685-0223) Irrigation and Water Management I (685-0280), the APS project, Southern Zone Water Management (685-0295), and Reforestation (685-0283).

Several projects have been designed expressly in the last three years to increase agricultural output in different ways: the APS with its focus on development and distribution of improved seeds; Irrigation and Water Management with its focus on improved rice yields and increased cropping intensity; Southern Zone Water Management with its focus on improved water control and reclamation of rice fields suffering from salt intrusion; and Reforestation with its focus on massive planting of trees as economically productive investments.

In 1986, USAID/Senegal's grasshopper eradication campaign was instrumental in averting crop losses in the northern peanut basin.

In the field of population and health, USAID/Senegal has made a major contribution to pushing the GOS toward formulating a population policy, an area in which President Abdou Diouf has taken the lead. Significant progress has been made in providing access to family planning services, and there has been a corresponding increase in contraceptive use. There are now 35 functioning family planning service centers, with most working at full capacity and many of them having to refer or defer clients because of the demand. Between December 1986 and December 1987, the number of family planning clients has increased by 47 percent. At present we have some 17,000 women utilizing modern contraceptive methods under our project alone. Project resources have also been successful in increasing the role of the private sector in the delivery of family planning services: private pharmacies are now distributing family planning supplies which would provide coverage for an estimated 15,000 additional women. Significant progress has also been made in establishing a partially self-sustaining village-level primary health care system under USAID's Rural Health Services II project (685-0242), which among its other activities is providing child survival interventions such as oral rehydration therapy, immunizations, growth monitoring, nutrition education, and malaria chemoprophylaxis.

VI. Remaining Challenges

Senegal still faces a number of major challenges. A.I.D. can help deal with some of them but not with all.

At the macro-economic level, Senegal industry is hampered by overvaluation of the CFAF in combination with labor force rigidities due to the labor code. Relatively high industrial wage levels will remain a problem unless rapid increases in productivity can be brought about.

Greater management efficiency and flexibility in implementing public sector reforms are needed.

Senegal's requirement for revenue mobilization will become acute as the windfalls to the GOS Treasury resulting from the past fall in world petroleum and rice prices are either passed on to users or consumers or else wiped out by reversal of world price movements.

The need for reform of the banking sector is urgent if the private sector is to get the credit it needs to expand and to take advantage of new opportunities resulting from the more favorable policy climate.

Adjustments in price policy are needed to optimize production, consumption, and revenues from peanuts and cereals.

Intensification and diversification of agriculture are needed if cereals and other crop production targets are to be met. Technological changes brought about by agricultural research are a necessary input to intensification.

Developing a national network of economically efficient artisanal and semi-industrial cereals transformation units is needed to market the planned increases in output of coarse grains in competition with imported rice.

Reducing the population growth rate is a fundamental challenge for the longer run. Increasing opportunities for employment (and self-employment) is the challenge for the shorter term. One partial solution to the employment problem is expanding the role of the private sector and continued progress in privatization, which are serious challenges of their own.

The major challenges in the health field are child survival, development of an effective national primary health care system, and dealing with AIDS.

To stem the desertification of northern Senegal, natural resource management ranks with reducing the population growth rate as a fundamental challenge for the life of the country.

Education reform needs to be implemented quickly so that the system can begin to provide relevant knowledge and skills and realistic expectations to Senegal's youth.

VII. Implications for U.S. Assistance

A. Overvaluation of the CFAF

Senegal's participation in France's West African Monetary Union (WAMU) provides too many economic benefits for Senegal to risk separating from the WAMU and managing its own currency. Devaluation of the CFAF, therefore, depends on the relation of the French franc (FF) to other currencies including the U.S. dollar unless France decides to modify the long-standing CFAF 50 for FF rate of exchange with all the members of WAMU. This is not a question whose solution is within USAID/Senegal's scope. It lies rather in the actions France has to take in preparing for full integration into Europe in 1992.

The related question of labor force rigidities is one we can continue to discuss with the GOS. However, the decision-making process is much more difficult in this case than in dealing with some other issues, since its involves amending the labor code by the National Assembly where labor union spokesmen have a significant voice. This is another issue that USAID should not take up unless we go full-square into support for industrial development.

B. Implementation of Reforms

The donor most directly concerned with public sector reforms is the World Bank. USAID can make a contribution to managing the implementation of reforms by urging and supporting development of an adequate data system, by maintaining a solid presence in the policy dialogue, and by selecting a few key issues to press reform hardest (e.g. SAED).

C. Revenue Mobilization: Follow-Up on Tax Reform

The GOS Tax Department is now intellectually committed to revising the income tax components of the General Tax Code to turn the present schedular system into a two tax system consisting of a unified global tax on individuals and a business tax on corporations. If the technicalities can be worked out in time, they hope to be able to present a draft bill containing a new code to the National Assembly in 1989. The immediate purpose of the reform is to create a simpler and (hopefully) more equitable tax system. The intention is that the new code should be revenue neutral - i.e., that aggregate tax receipts should not be lower than under the present system. That implies a redistribution of the existing tax burden among existing taxpayers. Those who find themselves hit harder by the new system than by the old will complain.

If we succeed in getting that far, the next steps will entail improving tax administration to widen the tax base, e.g. by refining assessment methods for non-wage income, and by implementing urban fiscal cadasters in the Dakar-Cap Vert region and in secondary cities. For the assessment question we will rely on technical assistance from the U.S. Internal Revenue Service and from our team of high level tax experts.

D. Banking Sector Reform

The Senegalese banking sector is currently in disarray, meeting neither the needs of its current limited clientele nor the development needs of the country. Liquidity is extremely tight, hampering the execution of ordinary transactions in some cases and severely limiting new loan activity, even of a relatively short-term nature. Competitiveness in the banking systen is limited owing to the concentration of ownership, with government having a significant equity position in the majority of banks. The loan portfolio of many of the existing banks is of poor quality with a substantial proportion of non-performing loans, particularly loans to the public, parastatal or cooperative sectors. Loan assessment has been weak, with excessive reliance on collateral requirements, and with far too little reliance on an assessment of the projected cash flow underlying individual loan requests. There is more than a little suspicion that loan decisions can be substantially influenced by non-commercial considerations. In many banks, loan follow-up is minimal, and attempts at loan collection are equally limited, at times influenced by the same non-commercial considerations apparent at the time of initial lending. All banks are subject to credit ceilings by sector, and most major banks are under substantial pressure to participate in cash crop lending (credit de campagne) where political and other risks of non-repayment have historically been high, and where profit margins are thin. Many Senegalese banks have been unwilling or unable to mobilize domestic deposits on a sufficient scale, with a resulting excessive reliance on discounting with the Central Bank (often in excess of legal limits). Profitability is often low (or negative) owing to the high cost of operations (including excessive personnel costs) and to the large proportion of non-performing loans. Low profitability militates against the growth of the banks' own capital, limiting the possibilities for expansion to new sectors of the economy or to new regions of the country, even where the banks' conservative temperament or limited expertise would otherwise permit.

Despite the many problems of the banking sector in Senegal, or perhaps because of them, we believe the U.S. has a specific role to play in designing and implementing a program of banking sector reform that incorporates a number of features: a reduced role for the state in credit allocation; an increased share of credit for the private sector; increased domestic savings mobilization; a broader capital base for banks; privatization; improved bank management; improved bank supervision and inspection; improved loan criteria and loan selection; improved loan follow-up; improved loan collection; and a broader outreach for the banking system based on improved incentives and profit-making opportunities. Much of this is an institution-building exercise that may require a multi-year effort. Most of this can be achieved within the existing regulations of the West African Monetary Union, given willingness on the part of the GOS to exercise the full authority available to its national credit committee, and given willingness on the part of individual banks to participate. In addition, we would expect Senegal to play a pioneering role within the West African Monetary Union, completing studies where necessary, and pushing WAMU in the medium-term for waivers or changes in regulations that could ultimately benefit all WAMU Member States. Structural adjustment in Senegal cannot wait for the evolution of WAMU policy to take its natural course, and questions of bank liquidity are even more urgent for the stability and growth of Senegal in the short to medium-term.

E. Price Policy Adjustment

New decisions have to be taken by April 1988 by the GOS for the 1988/89 agricultural campaign on three interrelated prices set by GOS fiat: the peanut procurement price; the floor price for secondary cereals (millet, sorghum, and maize); and the consumer price for imported rice. The peanut procurement price impinges on the deficit of the peanut sector, but so also does the efficiency of SONACOS which is under scrutiny through the technical audits commissioned by the GOS and by the French Caisse Centrale de Cooperation Economique. The cereals floor price is in principle linked to the procurement price for peanuts but is also dependant on the extent of external financial assistance forthcoming to support the floor price. The rice consumption price has several aspects that need to be reconciled: the role of the rice price in protection of market for coarse grains; the revenues accruing to the GOS Treasury from the positive perequation on rice imports; and the extent of smuggling of rice from the Gambia, which pleases consumers in the border areas but severely irritates the GOS Ministry of Finance. USAID/Senegal is participating in the price policy dialogue through our ESF-VI.

F. Intensification of Agriculture and Agricultural Research

Increases in agricultural income will result from intensification which, particularly in regions of rain-fed cultivation, will depend on the development of improved seeds, new varieties, and new techniques that is the task of agricultural research. Potential increases in production of cereals, which are the economic justification for our APS project, depend on the development and use of improved seeds, fertilizer, pesticides and agricultural implements, especially for rainfed agriculture. Availability of improved seeds will make fertilizer use economic to the individual farmer. The longer-run development of alternatives to peanut production, essential for Senegal in an era of declining world vegetable oil prices, will depend on the introduction and testing of new varieties. To meet the challenge of technology generation in cereals production, our amended Agricultural Research II project (685-0957), over its two remaining years, and the new project on Strengthening Agricultural Research will seek to improve ISRA's organizational efficiency and the quality of its cereals-related research. It will do this by assisting ISRA in the definition and execution of its cereals research program, addressing issues of scientific management, development of a scientific career track with incentives for researcher productivity, and manpower development, and by supporting cereals systems research.

G. Cereals Processing

The real key to achieving the aims of the Cereals Plan is the eventual success of marketing of secondary cereals in competition with imported rice. A requirement for that is economic processing of millet, sorghum and maize into consumable products as convenient to use as rice. At present the cost of industrial processing is too high for comparable cereal products (grits, couscous) to compete with rice on a price basis. The GOS now has a program for testing semi-industrial cereals processing, encouraged by USAID/Senegal, the World Bank, and the Common Fund. It is important to complete that program with the development of artisanal cereals processing as a further dynamic private sector activity.

H. Population Policy

USAID/Senegal has been the lead donor supporting the development of the GOS population policy paper (first draft already finished, final due mid-April 1988) as part of our bilateral Family Health and Population project. The Mission will participate in the execution phase of the population policy by its continued efforts with the Ministry of Public Health (family planning services in clinics), Ministry of Social Development (information-education-communication via the social services structure) and Ministry of Information (IEC via communications networks). Other resulting population programs will be left primarily to our donor partners (UNFPA, World Bank, UNDP).

I. Employment

Senegal's employment problem is high on the list of GOS concerns but finding solutions is not yet high on its list of accomplishments. The global situation is one of a rapidly increasing labor force in an economy that has started recovering from a deep slump only in the past three years. Youth unemployment is high among both the educated and the uneducated; delinquency in Dakar is therefore rampant and potentially explosive (as demonstrated by the post-election riots of February 28 and 29, 1988). Solutions are not readily discernible.

The immediate focus of the GOS is on how to reduce the negative impact of laying off government and parastatal employees by making operative a Reinsertion Fund financed by donor contributions. A more effective measure so far has been the negative one of taking no action against the underground economy based on Sandaga market in Dakar and the vibrant informal sector operating throughout the greater Dakar region and secondary cities, which leaves an income-earning safety value for market-stall businessmen and street vendors. Unfortunately the unemployed are likely to be joined by personnel laid off by formal sector enterprises hit by the New Industrial Policy and by the underground economy, and by bank sector employees once the banking system is forced to rationalize, before the growth potential of the New Industrial Policy is made effective.

The source for new employment lies in economic growth. The short-run recovery of the agricultural sector has had positive (though statistically unverifiable) effects on rural employment. It is also a major reason for the success of our Community and Enterprise Development (685-0260) project in Kaolack.

USAID's contribution to increasing employment in the near and medium term will be indirect: by demonstrating the replicability of viable loans to micro-enterprises in a context similar to that of the Kaolack project; by easing the credit situation of small and medium scale enterprises through our proposed assistance to banking sector reform; by encouraging private sector processing of agricultural commodities by small scale enterprises (e.g. rice milling and cereals processing); by contributing to agricultural productivity; and by increasing the role of the private sector in tree planting.

J. Encouraging the Private Sector

Expanding the role of the private sector is an objective that permeates USAID/Senegal's program. In agriculture, we have pressed at the policy level for reduction of the scope of state involvement in cereals marketing, in the supply of inputs, and in direct intervention in production through the rural development agencies. We are, for example, putting pressure on the GOS through ESF-VI conditionality to get SAED out of rice milling in the Senegal River Valley. At the project level, a major thrust of the APS is the use of a line of credit to promote private sector marketing of fertilizer and other inputs to agriculture and of private sector marketing of cereals. In the Reforestation and Soil Conservation project (685-0283), the focus is on tree-planting by individuals of varieties that provide income directly or are valuable as adjuncts to agriculture. The central theme of the Southern Zone Water Management project is the creation of water retention infrastructure by villagers who will benefit directly from it.

In population and health, we are encouraging private sector marketing of services and commodities wherever that is feasible.

In the case of our program grants, the major use of the CFAF counterpart of the ESF and AEPRP cash transfers is to accelerate payment of GOS arrears to private sector enterprises as a means of increasing their financial liquidity.

We have been encouraging privatization of the public sector enterprises through provision of technical assistance but so far we have not put any funding behind our exhortations. One of the components of our proposed AEPRP-II for banking sector reform will be support for privatization of the commercial banks.

K. Health

Our experience to date with child survival and the primary health care system (PHC) indicates that the best way to assure child survival is to re-structure and re-organize the way PHC services are delivered in Senegal. We will be missing the point if we concentrate only on particular technical interventions. We have experienced the reality that the PHC system in general and certain interventions in particular are constrainted by the laws, policies and practices under which the GOS and the MOH are organized. It is our point of view that the time is appropriate to address directly the root of the problem and to make continued assistance highly conditioned in order to achieve needed systemic reform.

The Mission's strategy for AIDS intervention in Senegal is to integrate this activity into the Sexually Transmitted Disease program that is being funded via our bilateral Family Health and Population project. Our emphasis will be on information, education and communication (IEC) and blood screening (diagnosis, transfusion, epidemiology). The fact that Senegal is a low prevalence country dictates the necessity for a vigorous effort to prevent the spread of the virus by all possible means.

L. Natural Resources Management

Building on our Reforestation (685-0283) and Southern Zone Water Management (685-0295) projects, USAID/Senegal working on a policy of a two-pronged approach to natural resources management: (1) to work in close coordination with the GOS to assist in the development of sound environmental and natural resource conservation policies and programs, and (2) to remain sensitive to environmental and conservation issues when developing and implementing projects. The Southern Zone Water Management project deals directly with water management issues. The project plans to develop small watersheds and perfect a set of water management methodologies to enable farmers to achieve better control over available water. In addition the Mission is exploring new initiatives in the fields of watershed protection and control, soil conservation, agroforestry and energy. Priority technical problems to be examined are: soil conservation and management; water conservation and management; natural forest and brushland management; small-scale renewable energy management. The regional focus will be on Casamance, the lower peanut basin (Sine Saloum), Eastern Senegal (Senegal Oriental), and the Senegal River Basin. Biological diversity concerns are incorporated into the Reforestation project which is designed to use a mix of proven tree species in the different locations throughout Senegal. The country has a functioning national park system which is a tourist attraction as well as a means of safeguarding fragile estuary and savanna ecosystems.

M. Education

USAID/Senegal is leaving the overall educational policy development problems to the World Bank and to France. We will concentrate on training to develop new attitudes and new skills needed to develop and to manage a diversified market economy through our participant training program.

VIII. Conclusion

Senegal has shown a sustained commitment to reform and growth. It has achieved some impressive results in the first four years of reform. Senegal faces the daunting challenge of staying the course in the face of many development constraints and the limited growth potential of a poor, Sahelian country. The social costs and the competing pressures and trade offs inherent in any serious reform process are now coming to the fore. Senegal will need more than ever in the next few years good counsel and a sustained flow of external resources.

Drafted by:HLubell/GCarner:rs:3/14/88

Clearances:

DIR:SJLittlefield____
AMB:LWalker__________
ADO:WNilsestuen (draft)
HPNO:DBaker (draft)
RLA:EDragon (draft)
PDO:DMyers (draft)

4549P

54932

USAID/SENEGAL

PRIVATE SECTOR STRATEGY

March 10, 1988

The Goal

USAID/Senegal's private sector strategy seeks to better living standards through an active private sector. It is based on the premise that liberalization of the economy and a growing role for private enterprise will improve access to resources and make for more efficient resource management, and that the result will be increased production, incomes and employment and better health. To support private sector development, the Mission's program does three things: (1) assists the government's structural reform effort to remove constraints on private business and to shift services from the public to the private sector; (2) encourages the private sector to absorb increased responsibility for tasks previously done by government; and (3) explores ways to strengthen the private sector through credit delivery, management training and technology transfer.

The Problem

Senegal needs a strong private sector to achieve the economic growth required to create jobs and increase income. It also needs a strong private sector to increase the efficiency of services in areas such as health and agriculture that traditionally the government has sought to supply. Despite relatively good growth for the past two years, Senegal's growth rate since independence in 1960--an average of 2.3 percent per year--has been exceptionally low for an African country unafflicted by political disturbances. The lowest of French speaking countries in Africa, it has lagged well behind a three percent population growth rate and well below the pace required to absorb the 100,000 new workers entering the job market each year. Forty percent of the workforce is unemployed or under employed. Per capita income is half that of Cameroon and the Ivory Coast.

Most workers--more than two-thirds--are in agriculture, many in marginal jobs. But agricultural production--millet, sorghum, rice and cattle for domestic consumption, peanuts and cotton for cash and export--has been subject to the vagaries of government policies, climate and world markets. In a good year it produces two-thirds of the country's food needs and 19 percent of GDP.

A small industrial sector employs 10 percent of the workforce and provides 29 percent of GDP. Industrial growth has been stagnant; employment in industry has actually declined in the last few years. Services--trade, transport and tourism--employ 13 percent of the workforce and contribute 52 percent of GDP.

A\

Senegal's formal sector: Senegal's formal private sector is fragile and in transition. Although Senegal inherited a strong infrastructure and a relatively impressive private sector at the time of independence, independence also brought the fragmentation of the West African market. Companies serving a population of 27 million were forced to focus on a market of 3.5 million. Those that survived usually only did so with government protection, and where the private sector withdrew or failed to develop, the government felt obliged to intervene. As a result, Senegal's formal business sector is dominated by government, by public and parapublic companies. The government has majority participation in 86 companies and minority interest in some 100 others. It has majority interest in the largest groundnut oil processing enterprises and the two phosphate mining companies. It has interests in salt, cotton, fertilizer, ship building and repair.

Where the formal private sector exists it is dominated by a few large companies--usually French-owned. The Lebanese, who have long controlled small and medium-sized commercial enterprise, have substantially increased their holdings in larger commercial companies and moved into medium-scale manufacturing. Senegalese and Mauritanians have moved into petty commerce, and a few Senegalese have joined with French and Lebanese partners in areas such as fishing, which require 51 percent Senegalese ownership, or have gone into real estate and construction. Senegalese are also active in micro and small enterprise development and constitute, by and large, the informal private sector.

Private firms in the modern sector operate with a number of constraints. Profitability is cut by high production costs. Labor laws contribute to labor costs that are more than twice those of Benin, Togo or Mali, and labor productivity is only 25% of that in the Ivory Coast. Power costs are almost twice those of the Ivory Coast. New companies face a maze of tariffs and monopoly licensing arrangements that make breaking into an already limited market prohibitively difficult. And during the 1970's and early 1980's severe droughts sent agro-based industries into a recession and cut consumer demand for manufactured goods.

The fragility of Senegal's formal private sector is especially apparent in manufacturing. Some 300 companies employ 27,000 workers but a handful of companies are responsible for most of the employment and much of the production. Three companies, a French-owned sugar firm and the parapublic groundnut oil processing operations, employ nearly a third of all employees in manufacturing. A dozen state-owned firms account for 30 percent of manufacturing value-added.

Most plants operate under capacity; in recent years groundnut mills have operated at 30 percent of capacity, fish processing at 50 percent, textiles at 40-60 percent and some plants in mechanical industries at below 20 percent. Many companies, public as well as private, are deeply in debt; the average debt-equity ratio is 4:1.

But not all of the private sector is suffering. A limited number of companies have survived, even thrived, protected by high tariff barriers, monopoly licenses, customs exonerations, patronage, special access and influence. And the informal sector, uninhibited by the controls besetting the formal sector, operates freely, employing three times the workers in formal businesses.

Small and medium-sized enterprises: Small and medium-sized businesses appear to offer potential for considerable growth. A 1984 survey by Leopold Lawson carried out for USAID showed more than 900 small and medium-sized enterprises operating in Dakar, some employing as many as 200 workers, in metal, wood working, manufacturing, textiles, printing, construction and trade. Nearly 80 percent were Senegalese-owned. Capital costs per job created were well below those of larger firms. In the past two years, USAID's Community and Enterprise Development Project has identified in Kaolack and Fatick a robust small enterprise sector capable of borrowing at self-sustaining interest rates and realizing rates of return on investment often above 50 percent.

Policy reforms: The need to strengthen the formal private sector has become increasingly clear as the government has come to realize its own limitations. Beginning in 1983 the government launched a program of economic reform, imposing financial austerity and increasingly seeking to delegate responsibility to the private sector. The New Agricultural Policy included plans for liberalizing the supply of agricultural inputs and encouraging private trading of agricultural production; the 1986 Cereals Plan urged private sector participation in production, marketing, imports, storage and transportation. The New Industrial Policy called for disengagement of the state, privatization of public companies and increased incentives to private investors.

Three objectives of the structural reform are to boost the average annual rate of real GDP growth to 3.8 percent, to curb inflation, and to reduce the balance of payments deficit. To achieve these objectives will require expanded and diversified agricultural production both for domestic consumption and export; a key area of expansion should be in cereals production, as the result of liberalized marketing, increased irrigation and improved technologies. In industry, the effort is to remove government restrictions on private operators, increase competition, limit direct government supports and spur private decision-making and investment. The government has already reduced tariffs and quantitative restrictions on imports, eased some price controls, and has under consideration changes in regulations affecting labor.

The government has made good progress in its reform program. The impact, due to good weather as well, is reflected in the 4.2 percent growth in GDP during the past year (1987). The government remains committed to a continued strategy of promoting private initiative and increased efficiency through price and incentive policies, privatization of state-owned enterprises and services and a reduced government involvement in production.

The transition to a free-market economy will not be easy. Cutting back public involvement and removing protection in specific industry sectors, the restructuring necessary for sustained growth and increased jobs in the long term, will carry real immediate costs. A 1986 study by the Boston Consulting Group concluded that restructuring could eliminate 2,750-4,100 jobs in the short run and certain activities would be forced to close down completely. The cost of full restructuring was estimated at CFAF 7-11 billion.

Perhaps the greatest difficulty will be convincing private investors of the government's commitment to private decision-making. After years of struggling in an environment dominated by government controls and competition, private investors are chary of investing in areas long considered the government's domain. It takes time to build their confidence. They require assurances that the direction of the reforms are set and the pace is steady. More practically, they require clear and stable rules governing private operations in particular sectors.

USAID's Strategy

The CDSS states USAID's immediate objective as participation "in a cooperative effort with the GOS and other donors to restructure the Senegalese economy and lay the groundwork for positive growth." The goal is "a positive per capita rate of increase in GDP."

To achieve this goal, USAID's strategy is to support Senegal's shift from a state-controlled economy to an economy increasingly governed by private decision-making in a market-driven environment. In agriculture, the focus is on the implementation of the new agriculture policy, on the effort to promote domestic cereals production and to privatize internal marketing and import of cereals, and on decontrol of imports and agriculture inputs. In industry, USAID supports the new industrial policy aimed at increasing the competitiveness of Senegalese production by removing tariff and quantitative protections, privatizing government corporations, and easing restrictions on labor.

Through program support, USAID encourages the steady pace towards a liberalized environment for private business to stimulate private operators in supply and marketing of agricultural inputs, to encourage new investors in industry and force improved efficiency for existing operations, and to increase the productivity of the informal sector. Through project assistance, the strategy is to increase the use of private networks in key areas of agriculture-related marketing and environmental protection and to increase the role of the private sector in health and family planning. It will strengthen the capacity of the private sector to play a role by increasing its access in three areas: credit, training and technology.

Program Support for Policy Reform: Non-project assistance includes the Economic Support Program Grant (FY 86 ESF-IV $12.5 million, FY 87 ESF-V $11.5m, FY 88 ESF-VI $10 million), the Senegal Africa Economic Policy Reform (AEPRP) Grant (FY 86 $15.0 million), and the PL 480 Title I program loan (FY 86 $9.5 million, FY 87 $10 million, FY 88 $5 million). These programs provide budget support for the government's policy reform program and encourage focus on specific objectives through conditionality, self-help measures, and specific uses for local currency proceeds.

The ESF funds, provided as cash transfers, have aimed at liberalization of the agricultural sector. The government has shifted responsibility for distribution of agricultural inputs to the private sector. It has eliminated subsidies to the peanut oil pressing firms, ended its management of peanut seed stocks, and opened cereals marketing to private traders.

AEPRP I supports a package of tax and tariff reforms aimed at increasing the mobilization of domestic resources. Since 1986 the government has reduced the average level of tariffs by 40 percent, narrowed the number of goods affected, and removed quantitative restrictions on imports (except for those covered by special agreements). Counterpart funds are being used to reduce government arrears on payments to private firms. The tax code is now being reviewed, and the government is trying to negotiate an end to special agreements that exempt certain businesses from tax. It is trying to expand the tax base and is strengthening tax and customs administration. Under an AEPRP-II the Mission plans to negotiate conditionality on banking sector reform and will finance technical assistance for restructuring and privatization of publicly owned banks.

PL 480, through self-help measures and local currency, reinforces the Mission's dialogue with the government on its efforts to shift responsibilities to the private sector. One of the first self-help measures, for example, was the removal of restrictions on private marketing and transport of local cereals. Subsequently, the government lifted all restrictions on purchase, transport, and storage of local production. Another is the progressive elimination of fertilizer subsidies and encouragement of private sector fertilizer distribution.

Project Assistance for Implementation: New Mission projects are designed to engage the private sector in implementation of activities in the Mission's priority areas --agriculture, health and natural resources management. They seek to use the private sector in areas where the government is beginning to shift responsibility for services to the private sector. Because the private sector is often undeveloped in these areas and because the role private investors or traders are being asked to assume is relatively new, the targetted activities are high risk in the short term. There is, however, no choice in the long term. Senegal must delegate the responsibility for delivery of agriculture inputs and marketing of production to the private sector. The government cannot afford to supply all health care needs. Reforestation can only take place with significant private involvement. Management of water must be carried out by private users, supported by private services for irrigation development, operations and maintenance.

o Agriculture Production Support: The $20 million project aims at the development of a private seed multiplication program and increased private processing, distribution and marketing of cereals. It includes a $9 million credit component for agricultural input suppliers and production marketing to be run through local banks.

o Reforestation: The $10 million project encourages the development of private tree nurseries and plantations by working with private individuals, communities, and local organizations to demonstrate the benefits of agro-forestry, e.g. increased yields and tree products as cash crops.

o Irrigation and Water Management: The $8.5 million project will utilize local private firms for design, construction, and rehabilitation of irrigation systems in the Bakel area of the Senegal River Basin. This will involve building private sector capacity to provide irrigation services to local farmers.

o Southern Zone Water Management: The $18 million project now in design focuses on strengthening the capacity of local, private water-user organizations to build and maintain small anti-salt and water retention dikes and contour berms to reclaim land and to increase agricultural production. Local private sector firms will be used for dike and berm construction.

o Family Health and Population: The $20.6 million project includes a $1.5 million private sector component to encourage private companies to include family planning as part of health services made available to employees.

Direct Assistance to Develop the Private Sector: The Mission is also providing direct assistance, both program and project, to strengthen services to the private sector in three areas: credit, technology transfer and training. The most important of these areas is credit which the Mission considers the major constraint on private sector growth. It has two credit projects already underway---Community and Enterprise Development and Agriculture Production Support. It is examining other initiatives as well and is preparing both policy and direct assistance to speed banking sector reform under AEPRP II.

The sectoral focus for the direct assistance is agriculture and agriculture-related industrial development. This is based on the premise that Senegal's near-term growth must come for improved agriculture and a more dynamic agroprocessing industry. These are the areas that hold Senegal's greatest potential and comparative advantage.

Credit: Senegal suffers from an ailing and unresponsive banking sector. The country's banks face a liquidity crisis brought on by state targeting of loans, poorly performing loans, lack of internal controls, and rapidly deteriorating portfolios. Four banks in which the government has substantial interests have $367 million in bad debt. Credit available to the private sector has steadily diminished. During the 1970's private borrowing represented 24 percent of total credit. By the mid-1980s this had dropped to five percent, virtually all short-term. The lack of credit is a serious, perhaps the most serious, constraint on private sector development.

The Mission has already begun efforts to improve access to credit for small and medium-sized businnesses and for agriculture-related traders. Under its Community and Enterprise Development Project, the Mission is experimenting with approaches to small enterprise credit. The project has made 175 loans to small enterprises during the past year at interest rates--24 percent-- well above the formal commercial rates. With a default rate of less than five percent, the project now faces the daunting challenge of using the lessons it is learning to convince private bankers to take up small enterprise lending or to create a new and independent structure for such loans. The goal is the institutionalization of an approach to small enterprise credit through a private self-sustaining operation. Options being examined include a mutual society, credit union, private bank and NGO.

The Agriculture Production Support Project Provides funds through commercial banks for direct lending to traders supplying agriculture inputs or to purchasers of agriculture production. Technical assistance to formulate and implement reform of the banking sector itself will be prepared under AEPRP II. Through the Common Fund, the Mission is working with other donors to establish a system of credit for cereals-related lending. It is examining the

16

possibility of credit through an approach similar to the model developed under the Agriculture Production Support Project, through the Community and Enterprise Development Project or through credit cooperatives.

At the same time, the Mission has been active in discussions between the GOS and the donor community on banking sector reform. It has participated in policy meetings and prepared comments on proposed reforms. It is proposing technical assistance to banks on inspection and supervision, credit allocation and loan recovery as part of AEPRP II.

Training: The second area in which the Mission is making a sustained effort to strengthen the private sector is in training. Through the Sahel Regional Financial Management Project we are providing training in financial management to private bakeries and to the local accounting association. We are exploring the establishment of a linkage between the CESAG, the regional management training center for West Africa, and an American management training institution. We are looking at the possibility of encouraging CESAG to develop a capacity for small enterprise training and development which would institutionalize some of the curriculum and training methods developed under the Community and Enterprise Development Project. And we have included both short and long-term training for the private sector in our Country Training Plan.

Technology Transfer: Under the Technology Transfer project, the Mission is exploring approaches to transfer appropriate technologies to Senegal's private sector. It has imported water buffalo to test their suitability for meeting the animal traction needs of small farmers. It is exploring processing of traditional crops such as millet, cowpeas and fruit. An area of growing interest is work with the Food Technology Institute on the adoption of food processing technologies by small and medium entrepreneurs. During the past year, the Mission has been exploring ways to encourage private mango drying businesses. We expect to continue these efforts in the next two years under an amendment to the Technology Transfer Project. The principal focus of that amendment will be the use of appropriate technologies in agro processing and marketing, one of the few areas of industry which appears to hold potential for small and medium-sized businesses.

Next Steps

Under our current program we will continue to provide assistance for private sector development concentrating on (1) policy--setting the environment for a dynamic private sector; (2) implementation--getting the private sector involved in agriculture, natural resources management and health and family planning, our key areas of concern; and (3) direct assistance to the private sector through credit, training and technology transfer focusing first on credit and on development of small and medium-sized companies in agro-related industries.

During the next year we are planning a number of steps to refine and advance that strategy:

1. Assistance to the banking sector (fourth quarter, FY 88): Our major new initiative will be banking sector reform. We are convinced that a concentrated effort to remove the constraint on credit and increase the responsiveness of the banking sector is the best single investment we can make to spur private sector development. We will explore financial assistance in support of privatization and reform along with technical assistance to banks in inspection and supervision, credit allocation and loan recovery to be funded as part of AEPRP II. Technical assistance to banks under AEPRP II would support efforts on credit development through APS and Community and Enterprise Development Projects. It would also lend practical strength to policy efforts to reform the banking sector.

2. Private sector needs assessment (fourth quarter, FY 88): in June and July, with the Bureau's assistance we will undertake a private sector training needs assessment. The assessment will analyze manpower constraints on private sector development and the resources, public and private, in-country and abroad, to address them. It will look at training in areas such as accounting, management, finance, marketing and entrepreneur development.

   The study also will provide context to our early discussions with CESAG, the regional West Africa management training institution, and with other public and private institutions on the possibility of institutionalizing the capacity for entrepreneurial training. Senegal's informal and small enterprise sector holds real promise. The informal sector now provides three times the number of jobs as the formal sector. Unencumbered by the statist control which has affected formal companies, informal entrepreneurs have operated with a verve that has given Senegalese traders and businessmen a world-wide reknown. How to capitalize on that creativity, help small businessmen become larger and effectively link the informal sector to formal operations in a newly liberalized economy remains a major challenge. The training being carried out in the Community and Enterprise Development Project holds promise. Other efforts at entrepreneur training, most notably that being done by the Center for Entrepreneur Development in Ahmedabad and MSI in the Gambia, may be possibilities. The EDI at the World Bank has made some efforts to graft the CED program to Senegalese institutions. The private sector training needs assessment will help us examine that experience and various alternatives.

3. Assistance in Employment and Enterprise Policy to the Ministry of Finance (fourth quarter, FY 88: We are exploring possible assistance to the Ministry of Finance in preparing studies on a wide range of issues--trade and industrial policy, tax, labor regulation, investment code--that affect private sector development. We have cabled AID/W about the possibility of buying in to an existing project such as S&T's Employment and Enterprise Policy Analysis Project. We are also considering the preparation of case studies based on clients under the Community and Enterprise Development Project which can provide examples of specific policy constraints on small and medium-sized enterprises and might eventually be used in training materials for a small business development course.

4. Development of a PVO strategy and co-financing project (first-third quarters FY 89): We are looking at local and US PVOs in Senegal as possible intermediaries for a USAID effort to help develop the informal sector. During the next few months we will be reviewing our PVO program and developing a PVO strategy as part of our private sector program. Again, the Community and Enterprise Development Project through its work with PVOs and its credit efforts is providing useful information both on the problems of small entrepreneurs and on the ability of PVOs to help deal with them. In addition, three AID/W-funded matching grants to US PVOs include private sector components may produce useful approaches to PVO small enterprise development. We will begin work on the project implementation document for a co-financing project with PVOs in September. We are considering aiming the project particularly at those PVOs interested in income generating projects and development of small enterprises.

5. Assistance to agroprocessing (ongoing): Continuation of efforts under the Transfer of Technology Project to provide technical and marketing assistance to private operators.

6. Private sector strategy assessment (first quarter, FY 89): We are considering requesting AID/W assistance next fall to undertake a private sector strategy review. The review will provide a broad overview of the major constraints on private sector development against which to measure our current strategy. It will survey major policy areas: tax, trade and industrial policies, licensing, restrictions on labor. It will look at services available to private businesses---legal, marketing, credit, accounting and technology transfer and describe ways in which those services can be improved. It will help us to make adjustments in our portfolio and to design the work anticipated in credit and the banking sector and in assistance to small and medium-sized business, particularly in agro-related industry. Finally, it should provide insights into areas for future consideration, perhaps as part of the next CDSS.

Clearance: DDIR:S.J. Littlefield
DDIR:GCarner
PRM:HLubell
PRM:RGreene
ECU:JSikes

Drafted: DMyers, PDO

3199-0

84