

INTERNATIONAL MONETARY FUND
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

REPUBLIC OF SENEGAL

**POVERTY REDUCTION STRATEGY PAPER—ANNUAL PROGRESS REPORT
JOINT STAFF ADVISORY NOTE**

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and the International Development Association

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I. OVERVIEW

1. **Senegal's poverty reduction strategy paper (PRSP) was distributed to the Executive Boards of IDA and the IMF in October 2002, after endorsement by the Presidential Council in July 2002.**¹ It covers the period 2003–05. The joint staff assessment concluded that the policies contained in the PRSP provided an adequate framework for the country's objective to fight poverty.² The PRSP was welcomed by the Executive Boards in December 2002 as a sound basis for poverty reduction and concessional financing.

2. **Senegal's first annual PRSP progress report provides a candid review and analysis of the implementation of the PRSP.** The progress report (hereafter the Report) was prepared through a broad participatory process and covers (i) the progress made in the implementation of the PRSP since December 2002 focusing on its main pillars and cross-sectoral themes, and (ii) perspectives for 2004.

3. **The Report highlights that, overall, the first year implementation of the PRSP was adequate.** The government maintained appropriate macroeconomic policies during

¹ www.imf.org, www.worldbank.org: Senegal-Poverty Reduction Strategy Paper, 2002.

² www.imf.org, www.worldbank.org: Senegal-Poverty Reduction Strategy Paper-Joint Staff Assessment, December 2, 2002.

2003, with real GDP growth exceeding 6 percent. The authorities have also improved the diagnosis of poverty in Senegal, which was a weakness of the original PRSP. The new poverty data (collected in 2001–02 and recently analyzed in a joint study by the government and the World Bank) indicate a significant reduction in poverty over the past decade, and pinpoint the determinants of poverty in Senegal at the macro and microeconomic levels. This new analysis confirms the priorities initially defined by the government in its poverty reduction strategy during 2002.

4. **The Report also notes that in some areas, implementation of the PRSP has been uneven.** Senegal's poverty reduction strategy is built on four pillars: (i) wealth creation; (ii) capacity building and the provision of basic social services; (iii) improving the living conditions of vulnerable groups; and (iv) monitoring and evaluation. The government has realized progress in strengthening the first pillar with fitting macroeconomic policies, improvements in the investment climate through tax, regulatory and administrative reforms, and progress in structural reforms in the water and telecommunication, and electricity sectors. By contrast, reforms in the groundnut sector have been delayed. The second pillar of the PRSP has also received substantial attention from the authorities, through the implementation of reforms aimed at strengthening public expenditure management. But spending irregularities in 2003 have revealed severe deficiencies in fiscal transparency and procurement practices, which the authorities have started to address. While the latest data indicate a marked reduction in poverty over the past ten years, the Report provides little information on policy initiatives targeting vulnerable groups in 2003. Implementing measures to improve living conditions of these groups should be an important agenda item for the second year implementation of the PRSP. The last pillar has seen some progress, notably through the activities of the PRSP Secretariat and the gradual establishment of regional PRSP committees.

5. **There remain shortcomings and challenges on which the authorities will need to concentrate in the future.** These include the need for (i) improving fiscal transparency and procurement practices; (ii) strengthening the links between policy implementation and the PRSP objectives, notably through more and efficient decentralization; (iii) better aligning public expenditures with the priorities of the PRSP to achieve the ambitious medium- and long-term targets, especially, those aiming to improve the living conditions of vulnerable groups; (iv) identifying the binding constraints to improve absorptive capacity in both public and private sectors to facilitate the execution of poverty reducing programs and proposing remedial measures; and (v) strengthening monitoring and evaluation of the PRSP through the full implementation of the institutional framework and periodic reporting on the evolution of the quantitative indicators aimed at measuring progress toward long-term PRSP objectives and the Millennium Development Goals (MDGs), which is of utmost importance for the credibility of the PRSP process.

6. **Recent economic developments have confirmed that the main risks for the successful implementation of the PRSP are both exogenous shocks—such as the drought in 2002 and the recent sharp increase in oil prices— and endogenous difficulties in implementing structural reforms—in particular with respect to**

governance, and in the groundnut sector. The authorities' continued efforts to diversify the economy, a key element of the wealth creation pillar, should help to mitigate the first risk. Donors' assistance should also be called to cope with exogenous shocks. The second risk needs to be tackled through: (i) sustained efforts to strengthen public financial management, including in particular fiscal transparency and procurement practices, at the central and local government levels, and the management of resources transferred to local governments in accordance with the government's decentralization strategy; (ii) completing reforms in the groundnut and electricity sectors; (iii) further work on integrated sector strategies that link institutional reforms to investment programs; and (iv) further increasing institutional capacity dedicated to improving governance.

II. PROGRESS WITH POVERTY REDUCTION POLICIES AND PROGRAMS

A. Macroeconomic Policies

7. **Consistent with Senegal's three-year arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF), the government continued the implementation of appropriate macroeconomic policies in 2003.** In spite of the economic slowdown caused by poor weather conditions in 2002, the government continued to focus on enhancing revenue mobilization, prudent public expenditures execution, and reallocation of public resources to social sectors. Supported by a small and well targeted fiscal stimulus, and the easing of monetary conditions by the Central Bank of West African States (BCEAO), the economy regained its growth trajectory and inflation remained low.

8. **Economic developments were satisfactory in 2003.** Real GDP growth reached 6.5 percent, as agricultural output recovered from the weather induced contraction in 2002, and the secondary and tertiary sectors expanded by about 6 percent and 4 percent, respectively.³ Contributing factors were improved rainfall, the rise in the level of public expenditure with, in particular, the introduction of an emergency program to support the rural population, and an accelerated program of spending of resources freed by Senegal's debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC). Consumer price inflation was virtually absent. The external current account deficit (including current official grants) is estimated at 6.5 percent of GDP as against 6 percent in 2002, mainly because of the weakness of certain export sectors (mining, groundnuts) and rising imports of goods and services (petroleum, food).

9. **The fiscal stance remained prudent in 2003.** Improvements in tax administration yielded an increase in the tax/GDP ratio to the level targeted in the PRSP (18.2 percent of

³ This joint staff advisory note uses the most recent IMF staff estimates of macroeconomic performance, including fiscal performance. These estimates vary slightly from those presented in the Report, which had to rely on earlier estimates that have become superseded by more recent information.

GDP). The fiscal stimulus, including more HIPC spending, caused both the overall fiscal balance (-1.4 percent of GDP) and the basic fiscal balance⁴ (0.6 percent of GDP) to slip below the levels assumed in the PRSP (respectively, -0.5 and 1.4 percent of GDP under the middle-case scenario). Nonetheless, the fiscal stance remained consistent with the authorities' dual goals of maintaining fiscal prudence and realizing higher spending on the PRSP priorities.

10. **However spending irregularities in 2003 that came to light in June 2004 have revealed severe deficiencies in fiscal discipline and transparency that the authorities have started to address.** In 2003 the government committed public resources for infrastructure projects without the required budgetary allocation. The contracts for these projects amounted to about 1 percent of GDP. In the absence of allocations in the 2003 budget, contracts signed with firms in 2003 carried a promise of payment with resources from 2004 and 2005 budgets⁵. These projects are compatible with overall fiscal sustainability but were not included in the list of priority projects of the PRSP. They mainly consist of road infrastructure work and renovation of administrative buildings in Thiès, the second largest city of the country, which the authorities have justified as part of their policy to create new regional focal points of development in secondary cities in line with the wealth creation pillar of the PRSP. The implementation of these projects revealed important deficiencies in fiscal discipline and transparency, as well as in procurement practices and laws. In order to address these shortcomings, the authorities have started to implement the following remedial actions: (i) this spending has been fully incorporated in the 2004 budget; (ii) the authorities will clearly identify budget lines for all planned infrastructure works in their next annual and three-year public investment programs; (iii) the authorities have committed to refrain from signing any contract before the required budget allocations are approved by parliament; and (iv) the authorities will, in consultation with the World Bank and the IMF, adopt a series of measures aimed at improving procurement practices, including curtailing the use of emergency procedures (without competitive tender), and a revision of procurement laws with a view to removing loopholes which facilitated these spending irregularities.

11. **In view of recent and projected growth performance, the staffs believe that the authorities should continue to base their financial programming on the PRSP's more conservative growth scenarios.** The growth performance in 2003 and the output growth expected for 2004-05 (6 percent) reinforce the view that the optimistic growth PRSP

⁴ Budget revenue minus total expenditure and net lending, excluding externally financed capital expenditures and on-lending of external loans to other public entities.

⁵ Although some projects were executed by firms in 2003, this spending did not affect the fiscal accounts in 2003 because public expenditure is recorded on a payment order basis in accordance with WAEMU directives and payment orders were issued only in 2004. If public expenditure was recorded on a commitment basis, this spending would have increased the fiscal deficits reported in paragraph 9 for 2003 by about ½ percent of GDP.

scenario (7 percent on average over 2003-05) is not within reach in the near term. The authorities are on the right track of removing obstacles to investment and growth—with reforms in strategic sectors and steps to further improve the investment climate and efforts to increase the government's capacity to transform efficiently resources into quality services delivered at the central and local levels—but the pace of all these efforts may have to be accelerated to lift Senegal onto the higher growth trajectory. On the basis of current prospects, the staffs recommend that the authorities continue to program their financial policies on the basis of the PRSP's more conservative growth scenarios (around 6 percent on average over 2004-05), and continue their efforts to mobilize domestic resources to a level consistent with their medium-term priority investment program.

B. Poverty Reduction

12. **The staffs welcome the authorities' improved analysis of poverty in Senegal, based on the new data from the household survey of 2001/02**, which suggests a significant reduction of poverty and pinpoints the determinants of poverty at the macro and microeconomic levels.

13. **Contrary to the previous finding presented in the PRSP, the Report indicates that poverty declined in Senegal over the past decade thanks to relatively high GDP growth.** A joint study by the government and the World Bank has provided new estimates of poverty based on the 1994-95 and 2001 household surveys, suggesting that growth had a significant impact on poverty with the share of the population living in poverty decreased from 67.9 percent in 1994 (61.4 percent of households) to 57.1 percent in 2001 (48.5 percent of households). The decrease was larger in Dakar and other urban centers than in rural areas, a finding which should be further analyzed in the next Report in order to better understand the links between growth and poverty reduction. Despite these positive trends, the staffs note that perceptions of poverty show that about two-thirds of households identify themselves as poor and one-third of poor and non-poor alike felt poverty had substantially increased in their community over the last five years. However, half of the Senegalese population is hopeful that poverty will decrease in the next five years.

14. **The new analysis has considerably improved the diagnosis of poverty in Senegal and confirmed the validity of the priority actions identified in the PRSP. However, the Report does not fully spell out the policy implications of the concentration of poverty in rural areas.** In general, government spending continues to be skewed to the central level, to urban areas, and to better-off households. Since poverty is concentrated in rural areas, greater financial resources are needed at the local level to enable local governments to carry out in full the functions for which they have been made responsible by law since 1996. The system for transferring resources from the central government to local governments is inefficient and needs to be made simpler and more predictable. Also, significant training and capacity building at the local levels will be required so that the central government will feel confident that the transferred financial resources will be well used. Lastly, an effort should be made to enhance the development

of new private activities, especially small and medium firms, through improved access to credit and commercial information.

C. Sectoral Policies

Policies to promote wealth creation

15. **Building on discussions between the authorities and members of the Presidential Investors' Council, the authorities have improved the business environment.** Regulations concerning private investment, including “red tape” in business registration and taxation, were streamlined. The National Assembly adopted reforms that simplify the corporate income tax and the investment code in January 2004. In line with recommendations from the World Bank’s Foreign Investment Advisory Services (FIAS), the tax reform reduced the corporate income tax rate (from 35 to 33 percent), widened the tax basis by abolishing several tax exemptions, and introduced, for small enterprises, a single tax that stands in for income tax, value-added tax, patent contributions, and social security charges. The new investment code, that replaced the previous code adopted in 1987, broadened the scope of eligible sectors to take account of PRSP priorities and streamlined the system of investment incentives. In November 2003, parliament passed legislation for the creation of a National Anticorruption Committee that was set up in May 2004.

16. **In its effort to promote wealth creation, the government has initiated, albeit with delays, key structural reforms in the groundnut and electricity sectors.** In the groundnut sector, the government adopted its Policy Letter for Development of the Groundnut Industry in May 2003. The authorities launched a tender for the privatization of the groundnut processing state-owned company SONACOS in January 2004 and expected to conclude the process by end-May 2004. In June 2004, the authorities received only one eligible bid for the purchase of SONACOS. The bid is under negotiation, in view of its low level compared with the valuation of the company by an independent expert. In case the bid is finally rejected, the authorities envisage taking steps to strengthen the company’s financial position before launching a new privatization strategy in 2005. In the electricity sector, following the unsuccessful privatization of SENELEC in 2000 and 2002, the government adopted a new Energy Sector Policy Letter in March 2003, with the support of the World Bank. As part of the new sector strategy, SENELEC’s operating cash-flows considerably improved in 2003 with higher collection rates and lower operating costs, and the government has concluded the process of selecting a private independent producer (PIP) to increase generation capacity by 60MW (equivalent to about 13 percent) in the country. However, the recent decision to cut electricity prices by 5 percent in accordance with the current price formula, in spite of the recent sharp rise in oil prices, will weaken SENELEC’s financial performance in 2004.

17. **The staffs welcome the attention paid to the PRSP first pillar but agree that, as noted in the Report, most reforms need to be pursued further.** This challenge is particularly evident for the structural reforms initiated in the groundnut and electricity

sectors. The staffs recommend that the next Report discuss more explicitly actions and outcomes in other strategic sectors of the Senegalese economy listed in the PRSP, such as non-groundnut agriculture (given the importance of rural poverty), fisheries, industries, tourism, and SMEs. Similarly, the reform of the Mining Code, which the PRSP portrayed as a major obstacle to investment, needs to be addressed. The next Report should also discuss how the large infrastructure projects (*les grands travaux du Chef de l'État* such as the new airport and the Dakar-Thiès Highway), which are under consideration by the government but are absent from both the PRSP and the Report, and the infrastructure projects in Dakar and secondary cities fit into the poverty reduction strategy.

Policies to promote capacity building and basic social services

18. **Promoting capacity building has received considerable attention from the Senegalese government during 2003.** As part of its recruitment strategy of 15,000 civil servants during 2003-05, the government plans to enhance capacity in the main sectors of the PRSP, including education, health, justice, tax collection, and security. The authorities also approved two action plans supporting public expenditure management reforms (following recommendations of the Country Financial Accountability Assessment—CFAA and the Country Procurement Assessment Review—CPAR) and initiated implementation, with the support of donors, including the World Bank and the IMF. Over the past few years, Senegal has made significant progress in public expenditure management as reflected in the recent joint IMF and World Bank's HIPC Assessment and Action Plan (AAP) that concluded that Senegal now meets seven of 16 benchmark indicators, against four in 2001. The most important improvements have occurred in the areas of public expenditure tracking—notably in the priority areas defined in the PRSP, internal controls, and budget preparation. However, significant upgrading is still needed in internal and external control of budget execution and state-owned enterprises. The authorities should continue their efforts in these crucial areas as they should lead to higher transparency, more financial resources, and a better allocation of spending, both at the central and local government levels.

19. **The allocation of spending towards social sectors continued to improve as both the shares of education and health expenditures in total public expenditures (26.5 percent)⁶ and in GDP (6.0 percent) increased (by about 0.5 percent) in 2003.** The spending of HIPC resources (US\$153 million in 2000-03) on capital expenditures in social sectors has contributed to reinforce this positive trend. However, the growing share of education and health expenditures in total public expenditures and in GDP masks diverging

⁶ As defined in the completion point document for the enhanced HIPC Initiative (IMF Country Report No. 04/130 and www.worldbank.org, April 1, 2004, Appendix II, Table 2, p. 52). These ratios differ from those presented in the Report (see Table 6, p. 27). The latter reports ratios of smaller aggregates, namely, current education and health expenditures over total current expenditures, excluding interest payments and exceptional expenditures.

sectoral trends: while the shares of education spending grew during 2000-03 (from 18.3 to 21.3 percent of total spending and from 3.6 to 4.8 percent of GDP), the shares of health spending contracted (from 6.4 to 5.1 percent of total spending and from 1.3 to 1.2 percent of GDP), as a result of weak implementation capacity in this sector, both at the central and local levels.

20. **Although social sectors, such as education and health, benefit from a substantial level of financial resources, their contribution to reaching the MDGs has been uneven.** This is particularly the case for the health sector where progress in immunization coverage and maternal health programs has been insufficient for Senegal to attain two objectives that had been set as triggers for its completion point under the enhanced HIPC Initiative.⁷ The authorities are developing a new health sector strategy with donors in order to meet their medium-term objectives. This strategy is designed to address both sectoral and cross-cutting issues in the health sector and also target a few specific activities that are expected to produce better outcomes for the Senegalese population living in unhealthy conditions. It would be useful that the next Report provides a detailed account of the implementation of the new strategy in the health sector.

21. **It is recommended that the next Report include a more detailed analysis of the government's decentralization strategy for the delivery of basic social services in the regions.** The transfers of resources to local communities, which have received increasing responsibilities in delivering social services, continue to be problematic, even though some progress has been realized over the past year. These problems, including the slowness of these transfers and the absence of information about their allocation, continue to explain the relatively poor performance in the social sectors. They need to be resolved over the next few years so that Senegal can advance more decisively towards the MDGs. The next Report should more clearly analyze the authorities' decentralization strategy, notably whether the assignment of responsibilities to local communities is clear and in line with their administrative capacity.

Policies to improve the living conditions of vulnerable groups

22. **Vulnerable groups are numerous and diverse in Senegal, including children, handicapped, elderly, and refugees.** The PRSP emphasized the need to improve the lives of vulnerable groups and prescribed actions to ensure that these groups do benefit from wealth creation and access to social services. The broad PRSP strategy in this area is to (i) improve the social status of vulnerable and marginalized groups; (ii) facilitate the access of the indigent populations to basic services, infrastructure and facilities; (iii) implement

⁷ In view of remedial measures, including a new health sector strategy, the Executive Boards of IDA and the IMF considered that Senegal met the conditions to reach its completion point under the enhanced HIPC Initiative on April 19, 2004 (IMF Country Report No. 04/130 and www.worldbank.org, April 1, 2004).

wealth-creating programs adapted to the situation of these target groups; and (iv) promote community development.

23. **As noted in the Report, this PRSP pillar has received little attention from the Senegalese government over the past year.** The staffs found only scant references to actions or policies undertaken to improve the living conditions of vulnerable groups in Senegal during 2003. It is recommended that this crucial shortcoming be remedied as soon as possible and covered in depth in the next Report.

III. MONITORING AND EVALUATION

24. **The government's strategy has emphasized obtaining tangible results. Evaluating and monitoring the performance realized in key sectors is at the center of the PRSP, and was identified as its fourth pillar.** With this objective in mind, the government has designed an institutional framework that includes the Interministerial Committee chaired by the Prime Minister, the Steering Committee chaired by the Minister of Economy and Finance, the PRSP Secretariat, and regional committees.

25. **Over the past year, the government has reinforced the PRSP Secretariat and created the regional committees.** The Secretariat has reinforced its coordinating function, cooperated with the donor community, and implemented the first steps towards the monitoring of the PRSP process. Regional committees have been created in each of the eleven regions, chaired by their respective governors. However, these committees still need to become truly effective, which will require the harmonization of sectoral strategies in each region. As envisaged in the Report, the government has reinforced the institutional framework surrounding the PRSP by holding the first meeting of the Steering Committee in June 2004. The government has strengthened the participatory process, which was initiated during the PRSP preparation, with the identification of focal points in sectoral ministries, responsible for monitoring the implementation of the Sector Operations Programs. The authorities have started to disseminate the PRSP throughout the regions by organizing a series of workshops attended by a variety of representative groups in Senegal, including from the central and local governments, the donors' community, the private sector, and the civil society. This effort needs to be pursued, notably by reporting on a regular and transparent basis the PRSP results and outcomes to all concerned parties in Senegal.

26. **One of the objectives of the government has been to identify the list of indicators that will be used to monitor the PRSP progress with the participation of major partners operating in the country.** These indicators should help the authorities to evaluate the implementation of the PRSP over time and its consistency with the MDGs. While this participatory approach has had the merit to involve all partners and find a consensus among them, it has also considerably delayed the process. At this stage, an agreement has been reached on a first preliminary set of indicators but there is an urgent need to validate the list and report on the evolution of the selected indicators during the past few years compared to initial benchmarks and medium-term objectives.

IV. CONCLUSION

27. **Bank and Fund staffs believe that Senegal's first PRSP progress report provides a fair and encouraging assessment of the first year implementation of the PRSP.** The Report is comprehensive, highlights the risks ahead, and points to areas for further improvements. Significant progress has been achieved in strengthening the diagnosis of poverty in Senegal, and in initiating significant reforms relating to the first two PRSP pillars—wealth creation and capacity building. Furthermore, Senegal's macroeconomic performance remains encouraging, with sustained strong economic growth, prudent fiscal policy, progress with implementing the broad-ranging structural reform agenda, and a favorable outlook for the period 2004-06. However, fiscal transparency and procurement practices need to be strengthened and reforms in the groundnut and electricity sectors need to be completed.

28. **The Report, nonetheless, recognizes a few areas where gaps remain in the implementation of the PRSP, and these form an agenda for further work.** The staffs recommend, that special attention during the next twelve months be given to: (i) reforms aimed at removing obstacles to sustained growth in key strategic sectors such as groundnut and electricity; (ii) the remedial actions to address weaknesses in public financial management that led to the breach of fiscal discipline and transparency in 2003; (iii) the decentralization of resource allocation, since local governments are expected to receive gradually increasing responsibilities in delivering basic social services, notably in remote areas where poverty is the most acute; (iv) a comprehensive review of the rationale for infrastructure projects in Dakar and in secondary cities, and a progress report on their implementation; (v) efforts to strengthen the monitoring of progress towards the PRSP objectives and selected indicators consistent with the broader MDG objectives; and (vi) a better articulation of measures aimed at improving the living conditions of vulnerable groups. Finally, it is imperative to develop a better understanding of the link between sectoral policies, investment projects and PRSP medium-term objectives.