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SENEGAL

SELECTED ISSUES

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INTRODUCTION

1. **Senegal is at an important inflection point.** Growth in the past few years has been sluggish and did not make a meaningful dent in poverty. To exit the low growth/high poverty trap, the authorities have launched a new development strategy, "Plan Sénégal Emergent" (PSE). The plan aims at making Senegal an emerging economy by 2035 by becoming a hub for West Africa. To get there, 2015 should become a turning point from the mediocre growth of the past to the higher, sustainable and inclusive growth envisaged by the PSE.

2. **The PSE is articulated around three pillars:** (i) higher and sustainable growth in the range of 7-8 percent based on FDI and export driven structural transformation; (ii) human development and social protection; and (iii) improved governance, peace, and security. The PSE calls for continued fiscal consolidation, constraining public consumption and increasing public savings to generate fiscal space for higher public investment in human capital and public infrastructure. It also envisages structural reforms to attract FDI and increase private investment.

3. **This publication identifies the policy mix for the PSE to succeed.** The main challenges for Senegal are to accelerate, broaden and deepen reforms. Key institutional preconditions are to that end: strong ownership of the PSE at the highest political level, broad popular demand for reforms, and strong support from development partners. On the macro side, the prospects are also favorable: growth is accelerating, inflation remains low, and the fiscal deficit is under control. Senegal has access to concessional and non-concessional resources to finance its development agenda and should be able to do so with low risk of debt distress if it follows the fiscal consolidation path envisaged in the PSE and tightens public consumption, thereby creating space for public investment.

4. **The paper proceeds as follows.** Section 1 revisits the challenges of emergence by tapping on the experience of other countries across the world that became emerging economies in the past two decades. It then looks at the preconditions needed for growth acceleration in Senegal. Section 2 discusses options for strengthening Senegal's fiscal framework to support PSE implementation while keeping risks of debt distress low. Section 3 provides an assessment of Senegal's external stability. Section 4 explores how to improve the structure of the Senegalese economy to make it more competitive with more diversified exports. Section 5 discusses the electricity problem as a major impediment to growth acceleration. Section 6 makes a case for developing and enhancing social safety nets, in particular to protect the poor and most vulnerable in the process of major structural transformation. Finally, Section 7 takes stock of Senegal's performance under the 2011–14 Policy Support Instrument (PSI).

Box 1. Senegal: Main Findings and Recommendations

- **Peer-learning. *International experience suggests that PSE targets are realistic if appropriate policies are pursued.*** For the PSE to succeed, the Government of Senegal needs to distill the experience of comparator countries that successfully became emerging economies, and put in place the package of reforms required to attract FDI, increase private investment, and expand exports. An active peer learning effort is needed.

- **Growth. *Unlocking Senegal's growth potential is possible subject to bold reforms.*** The authorities should focus strong actions on supply constraints, such as creating a regulatory framework and business climate friendly to FDI and small and medium enterprises (SMEs). Investment in human capital and infrastructure, reducing inequalities by expanding private employment opportunities in the formal sector, and preemptive planning for adverse shocks to safeguard the fiscal space necessary for PSE investments are also needed.

- **Fiscal policies**. ***Improved revenue performance and expenditure composition are critical for creating the fiscal space to support the PSE***. The authorities are encouraged to specify the underlying fiscal measures associated with the PSE, strengthen the fiscal planning of the PSE with contingencies, enhance fiscal transparency, and improve the effectiveness of public investment.

- **Transformation**. ***To raise growth, investment needs to be accompanied by improved total factor productivity, investment in human capital, and broader financial inclusion.*** Diversification would benefit growth and stability mainly through increases in the shares of the existing products, complemented by improvements in their quality.

- **Electricity**. ***There is an opportunity cost for development spending, as the economy still faces bottlenecks from high electricity costs and insufficient electricity production***. The authorities should continue reforms of the sector. Cross-country experiences provide useful guidelines on successful reforms, particularly on the fiscal front. Senegal should also eliminate fiscal subsidies to the electricity sector and expand coverage capacity, provided it accelerates the introduction of new low cost electricity generation.

- **Social safety nets**. ***The share of the population living below the poverty line and its exposure to shock remain unacceptably high***. Strengthening social protection should be high on the authorities' reform agenda. The authorities are encouraged to work with the World Bank and other development partners on establishing safety nets capable of responding to transient needs and ensuring a minimum social protection for chronic poor and vulnerable groups of populations.

- **PSI implementation**. ***Overall, program performance in 2011–14 has been mixed.*** The macroeconomic performance has been below par but acceptable. Key goals of PSI were achieved but with outcomes less favorable than programmed. The qualitative targets were largely met, but substantial delays occurred in structural reforms. Technical assistance from the Fund was useful, although the implementation of its recommendations can be improved.

ACHIEVING THE PSE GROWTH OBJECTIVE[1]

This section proposes an analysis of factors that could facilitate the achievement of the Plan Senegal Emergent (PSE) growth objectives. First, it contrasts the international experience of countries that have achieved growth and those that have built up debt by ramping up public spending without accompanying reforms. Then it analyses the challenges facing Senegal to derive three main messages: unleashing Senegal's growth potential would require (i) strong action on supply constraints, such as the regulatory framework and business climate friendly to FDI and SMEs together with investment in human capital and infrastructure; (ii) reducing inequalities by expanding private employment opportunities in the formal sector, and bringing more equal access to education and health services; and (iii) planning for adverse shocks to ensure that enough fiscal space is preserved to sustain the PSE investment plan.

1. The *Plan Senegal Emergent* calls for Senegal to become an emerging market by 2035 and a hub for the region. The ambition is to make Senegal a key player in the region for a number of activities through better infrastructure, higher human development, and better governance. The plan sets to develop key sectors, such as agriculture, agribusiness, mining, and tourism. To achieve these goals, Senegal would need to accelerate its growth rate to the 7-8 percent range in the short-term, and sustain such rates in the medium term.

2. International experience suggests that the PSE growth objectives are feasible. Historically, growth accelerations have been a frequent yet unpredictable phenomenon. Nevertheless, growth accelerations driven by economic reforms tended to be sustained.[2] Also, episodes of sustained growth and growth accelerations usually coincide with a sharp uptake of private investment and trade. However, macroeconomic volatility and external shocks are negatively associated with the duration of growth spells, while export product sophistication tends to prolong growth.[3]

3. For Senegal, achieving growth rates around 7-8 percent amounts to a structural break compared to past performances. The PSE projects economic growth to double the performance recorded in the past two decades. Over the period 1995-2013, economic expansion was modest and volatile with an average real GDP growth of 4 percent and a 1.7 standard deviation. These growth fluctuations are partly caused by uneven agricultural production, exogenous shocks, and most importantly, by major bottlenecks in the supply side of the economy that will need to be

[1] Prepared by Ali Mansoor, Albert Touna Mama, Olivier Basdevant and Salifou Issoufou with assistance from Yanmin Ye.

[2] Hausmann, Pritchett, and Rodrik (2005) found that growth accelerations are frequent but unpredictable. They also found economic reform to be a statistically significant predictor of growth accelerations that are sustained.

[3] For volatility and duration of growth spells see Berg, Ostry, and Zettelmeyer (2012). For export product sophistication and growth duration see section 4 on "Growth, structural transformation, and export diversification in Senegal."

addressed for Senegal to achieve a balanced growth path.

4. **This section proposes an analysis of investment, trade, and reforms as ways to achieve the PSE growth objectives.** Senegal needs significant private investment, particularly FDI as well as investment in infrastructure and in human capital (education, health). At the same time, it faces significant supply constraints that hamper growth and development. Increased infrastructure spending, especially in transportation and power generation, is recognized as playing an important role in growth, and promoting regional and international trade. It can also help achieve social objectives such as access to clean water, education and health. In addition, the PSE also anticipates that unlocking these supply constraints could lead to a virtuous cycle of growth, whereby improved growth performance would increase revenue collection and, subsequently, increase fiscal space for investment spending without putting much pressure on the deficit or building up public debt.

A. International Experience

5. **The underlying analysis is based on two sets of countries.** The first set consists of high growth countries, which are identified based on average of annual growth in real purchasing power parity (PPP) GDP per capita and levels of real PPP per capita GDP in both 1990 and 2013. From this first set, and to facilitate drawing lessons on policy and institutional reforms, the analysis then focuses on 10 comparators which satisfy a number of additional criteria. The second set, high debt countries, is derived by applying a range of criteria pertaining to growth in debt position as well as the evolution of ratios of debt-to-GDP between 1990 and 2013 (see Annex 1).

6. **Historically, countries that have embarked on important investment programs have experienced mixed fortunes.** Between 1990 and 2013, about 46 countries have achieved an average growth in real purchasing power per capita GDP of 5 percent or more while another 43 accumulated debt without much growth to show for it. Of the 46 countries, the 10 comparators derived from the analysis are Cabo Verde, China, Guyana, India, Indonesia, Mauritius, Sri Lanka, Tunisia, Uganda and Vietnam.[4]

7. **The successful countries emphasized measures to expand exports through more FDI while those that accumulated debt did not seem to do so** (Figure 1). Indeed, comparators experienced sustained growth by relying on FDI-driven exports. During episodes of growth, and on average, exports increased by 20 percentage points of GDP for comparators while high debt countries, which include Senegal, saw no change in exports in percent of GDP during episodes of high debt. The FDI in percent of GDP followed a similar pattern during episodes of growth for comparators, rising from an average of 1 percent of GDP to nearly 4 percent of GDP in these 10

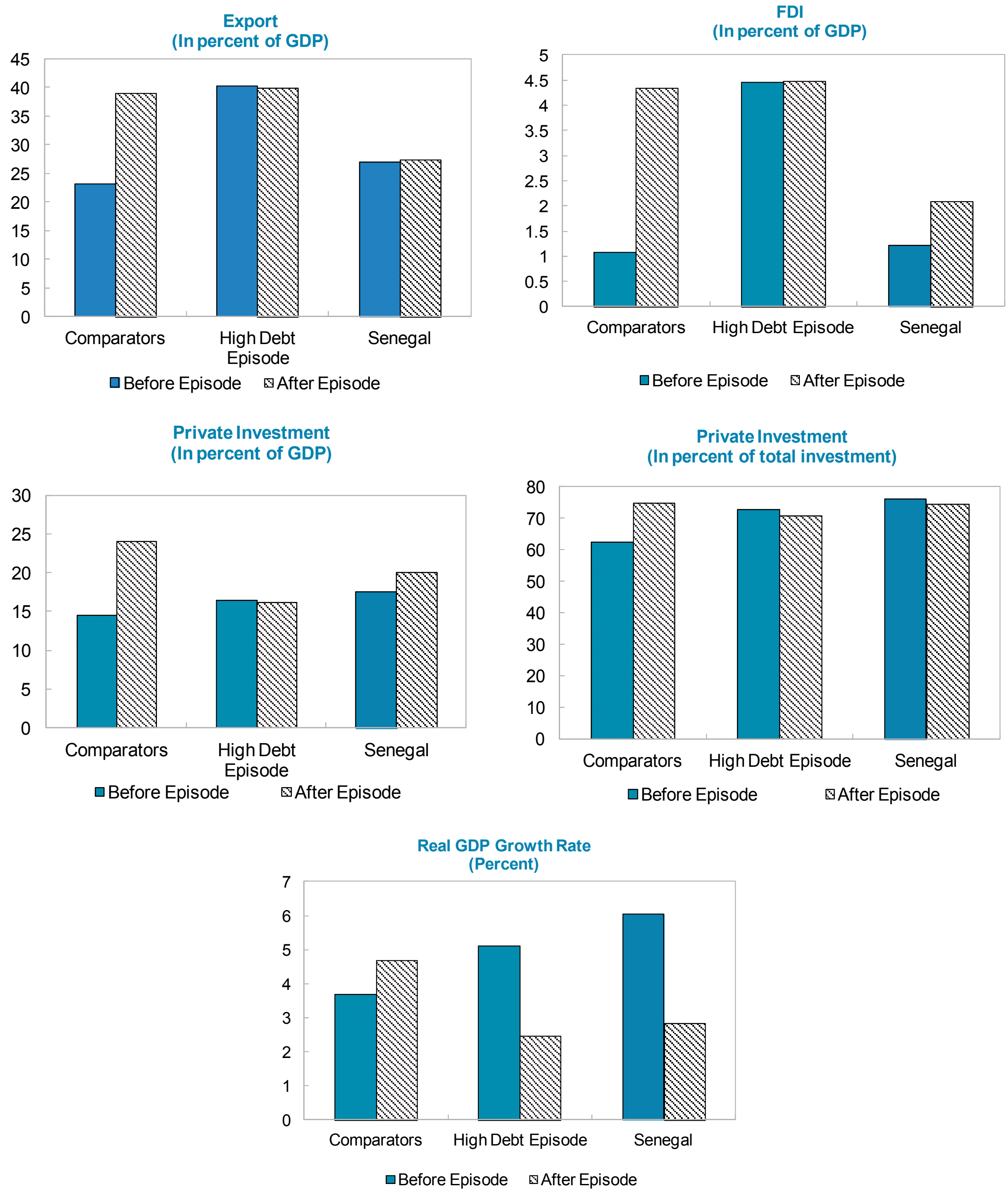
[4] This list only has 3 sub-Saharan African countries and contains China and India. An argument could be made that it may be unrealistic for Senegal to emulate countries like China and India. However, the purpose of the analysis is to identify countries that Senegal might want to emulate if it is to become an emerging market MIC in 30 years. It could do so by drawing on key lessons from policies and reforms that countries like China, India and the rest of the MICs comparators, have successfully devised and implemented to reach their present status.

countries. Although Senegal has noticeably higher share of FDI in percent of GDP, during the episode of high debt, its growth declined. This is partly explained by the lack of a significant increase in private investment, both in percent of GDP and in percent of total investment. The sustained growth in comparator countries seems to also be underpinned by increases in private investment in percent of GDP as well as in percent of total investment. For Senegal to achieve PSE set goals, it would need to devise and implement a critical mass of reforms to encourage private investment, promote and expand its exports, unlock supply constraints and promote inclusive growth.

B. Promote Exports and Export Quality, and Expanding to New Markets

8. As one of the 10 comparators, Mauritius is one example for Senegal to follow. Indeed, Mauritius achieved similar objectives as those of the PSE by promoting exports and by leveraging trade agreements. Despite poor natural resource endowments and high vulnerability to external shocks, the Mauritian story offers a remarkable example of how carefully orchestrated reforms, underpinned by the right institutional setup, can support successful structural transformation. In the post-independence era, Mauritius relied on preferential arrangement in the sugar industry and the Multi-Fiber Arrangement (MFA) preferences to promote exports of sugar and textile. Between 1980 and 2000, GDP per capita more than tripled to reach $3800 in 2000, while export increased more than tenfold to reach 60 percent of GDP in 2010. The economy expanded progressively from primary (sugar), to secondary (textile), to tertiary sector (tourism and financial services) to become an upper-middle-income economy today.

Figure 1. Senegal: Comparators versus High Debt Countries[1]

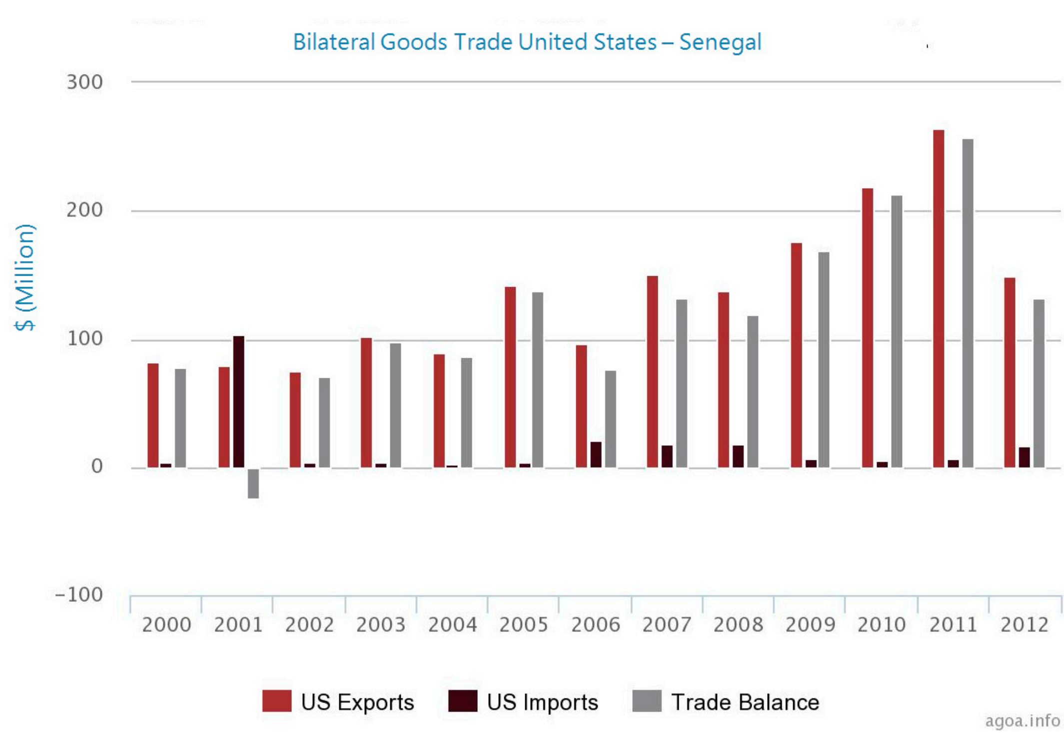


Sources: IMF staff estimates.

[1] High debt countries, including Senegal, are listed in Annex 1 of this section. "Before Episode" and "After Episode" are 3-year averages of the series. "Before Episode" refers to 3 years before the start of a growth episode (for comparators) and debt episode (for high debt episodes countries). "After Episode" refers to 3 years before the end of a growth or debt episode.

9. Senegal's growth strategy could greatly benefit from an integrated and coordinated export strategy. Ultimately, the PSE aims at boosting exports to its existing partners and mostly to the neighboring countries in West Africa. This should happen indirectly by improving competitiveness and raising productivity. Less than one percent of public financing under the current plan will go directly to an export strategy per se. The Mauritius case study suggests that a well-calibrated activist trade policy could yield great results, including by leveraging trade agreements. More specifically, better coordination of export-oriented industries, better access to appropriate financing, facilitation of improvement in quality and other standards could boost existing exports. For example, despite a preferred access to the US market through AGOA since 2000, US imports from Senegal remain marginal (Figure 3). To emulate Mauritius and other comparators, Senegal would also need to address key supply constraints that partly limit its growth potential.

Figure 2. Senegal: Bilateral Goods Trade, United States-Senegal



Source: IMF staff estimates and projections.

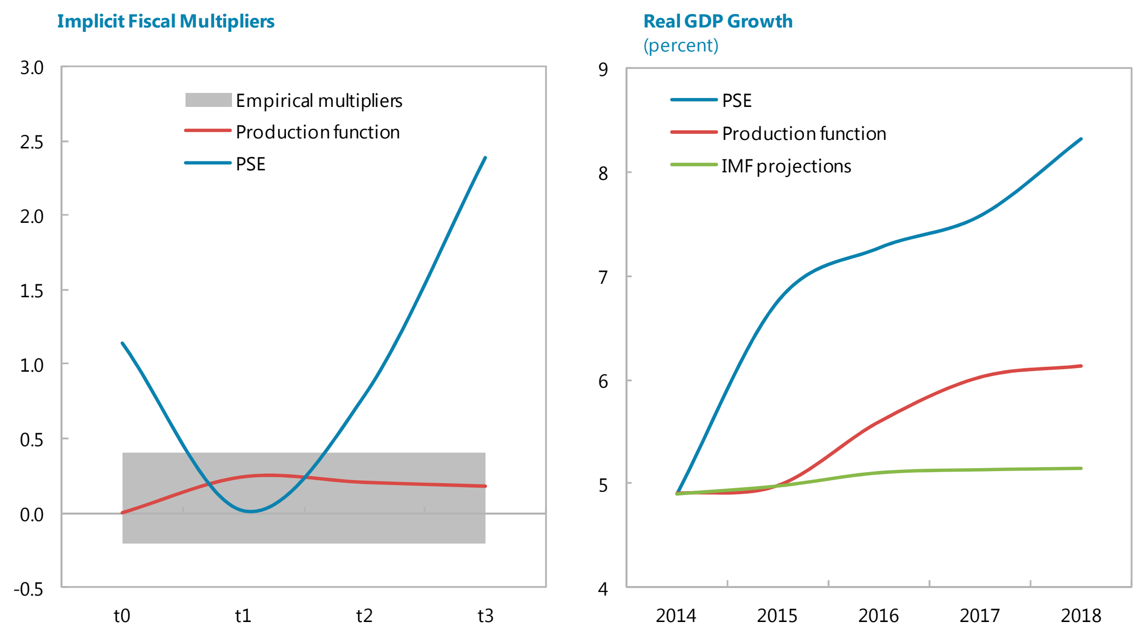
C. Unlock Supply Constraints

10. Unlocking supply constraints may take longer than expected because a critical mass of reforms needs to be in place before growth can reach the target. Since these reforms will take time to be enacted, this suggests revising the speed at which Senegal could reach a growth rate of 7–8 percent. According to the PSE, growth would rebound rapidly, within a year or two. It is expected that a "big push" with front-loaded public investment that crowds in private investment, including FDI, would lead to rapid gains. However, unlocking supply constraints is likely to take more time, as reforms to improve the regulatory framework and business climate for FDI and SMEs may take time. Moreover, undertaking new investment projects will take time to translate into effective productive capacity. A short-term growth rebound is unlikely to come from a demand effect related to increased public spending, because for developing countries, fiscal multipliers tend to be small, and sometimes even negative.[5] The multipliers are low because demand-driven stimuli are hampered by constraints on supply. This is particularly likely to apply to Senegal where, inter alia, electricity, transport and human capital available to the formal private sector are all areas which require policy attention. Moreover, the large informal sector and low levels of FDI are outcomes of a poor business climate, which is in turn clearly signaled by the poor rankings of Senegal in the Doing Business Index of the World Bank. To illustrate this point, we simulated an alternative growth path using a production function, to see at what speed additional public investment expenditure would translate into higher growth performances (Figure 3).

11. The growth path in the PSE appears to be implicitly based on multipliers that are much larger than those found empirically. These are unlikely to materialize until reforms to address supply bottlenecks are implemented. Indeed, the production function suggests that the gains in terms of growth while more gradual, could indeed be significant over the medium term as reforms tackle the supply constraints. Furthermore, the potential gains could, in the long run, be even more significant than envisaged in the PSE. With the right reforms, improved business climate and sound fiscal policy Senegal could crowd in the private investment, particularly foreign investment inflows, which are required to achieve its growth potential in an inclusive manner.

[5] Fiscal multiplier is defined as the overall impact on growth of a change in a particular fiscal policy instrument (e.g., a change in VAT rates). The survey by Spilimbergo, Symansky, and Schindler (2009) reports that fiscal multipliers in developing and emerging economies are between -0.2 and 0.4. Using World Bank lending data for 29 aid-dependent, low-income countries from 1985 to 2009, Kraay (2010) estimates that the output multiplier for government spending ranges between 0 and 0.4, but with estimates rarely significant. Based on quarterly data of government spending, Ilzetzki, Mendoza, and Vegh (2010) find that the cumulative, long-run multiplier for 24 developing countries is 0.18.

Figure 3. Senegal: Real GDP Growth Projections Under Different Multipliers Assumptions



Source: IMF staff estimates and projections.

D. Promote an Inclusive Growth

12. **PSE policies aimed at promoting inclusive growth will be critical to make a higher growth rates sustainable**. One critical challenge for many emerging or developing economies relates to the capacity to sustain growth over a prolonged period of time.[6] Sub-Saharan African (SSA) countries would typically encounter growth periods of GDP per capita that, on average, last about 11–13 years, and are also 10–11 years shorter than growth periods encountered in advanced countries and fast growing emerging economies (see Berg, Ostry and Zettelmeyer, 2012). In addition, SSA countries' growth periods tend to end with prolonged periods of negative growth (between about -3 and -7 percent). It has resulted in overall weaker growth performances, even if most of these countries did experience periods of high growth.

[6] Berg, Ostry and Zettelmeyer (2012) define "growth spells" as periods of real GDP per capita growth of at least 5 years, identified as beginning with an upbreak of per capita growth in excess of a minimum of 2 percent and ending wither with a downbreak followed by a period of an average growth of less than 2 percent, or simply the end of the sample.

13. Senegal has relatively lower performances than the average SSA countries. First, continued growth periods of GDP per capita lasted only about 8 years, in Senegal and second, the average growth achieved was lower than the average for SSA. Comparing Senegal against 4 of the 10 comparators (which had a similar level of income per capita in the early 1990s but have achieved growth performances similar to those envisaged for Senegal in the PSE, over about 35 years), four critical factors appear to explain why countries enjoy prolonged periods of positive growth: income inequalities, trade openness, political institutions, (i.e. the democratic degree of regimes), and FDI (Figure 4).[7] Three main stylized facts emerge.

- First, Senegal has received relatively high levels of FDI during its growth spells. It underscores how attracting foreign investors will be critical to Senegal growth performance. In particular, continued improvements in the business climate will be essential to maintain and develop Senegal's attractiveness. Here Senegal could do well to follow in the footsteps of Rwanda, which rapidly improved its business climate, and Mauritius, which strove to be in the top tier in Africa. Peer learning in this area has been supported by the World Bank and could be usefully explored.

- Second, over the past decade, Senegal has made two considerable changes to its institutions that bode well for achieving PSE growth objectives. First, Senegal has become more integrated into the global economy with more open international trade and improved diversification.[8] Second, Senegal has proven that its democracy functions well, with, for example, a peaceful political change during last general elections.[9] Thus, Senegal has the basic pre-requisites for prolonged periods of high growth as envisaged by the PSE. Indeed, based on empirical results, with these two institutional improvements, Senegal could have achieved a prolonged period of growth of about 24 years, instead of 8 years.

- Third, the main vulnerability that faces Senegal is the degree of income inequality. Indeed, comparing Gini coefficients between Senegal and comparator countries suggests that Senegal's distribution of income is about 20 percent less equal. This has potentially a very significant impact on growth prospects. Applying the result of Berg, Ostry and Zettelmeyer (2012), if Senegal had had a similar distribution of income as that of 4 comparators, its growth spells could potentially increase further from 24 years to about 32 years, i.e. almost exactly the average length encountered by the 4 comparators countries.

[7] These 4 comparators are: Cabo Verde, Indonesia, Sri Lanka, and Uganda.

[8] Senegal scored 0 on trade openness during its growth spell identified by Berg, Ostry and Zettelmeyer (2012), largely because Senegal marketing board, which was phased out in the early 2000s. Nowadays, Senegal trade is mostly liberalized, which would translate into a trade openness index value of 1.

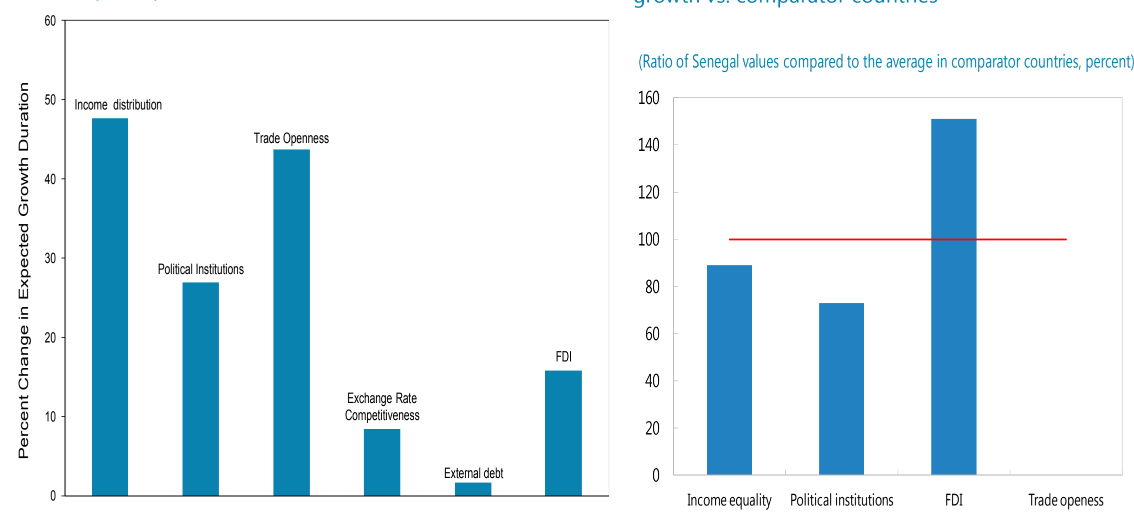
[9] During its identified growth spells Senegal had a much lower score in terms of democratic institutions, but has since made significant progress, highlighted by peaceful political changes, and a high score in the Polity IV index, similar to those of well established democracies (www.systemicpeace.org/polity/polity4.htm).

14. Thus, when implementing the PSE, Senegal authorities could adequately focus on effective measures to reduce inequalities. In particular, policies that are usually the most effective to provide durable improvements to income inequalities are based on creating opportunities for private formal sector employment and investment in human capital, i.e. reducing inequalities of access to education and health services. On the contrary, direct subsidies, especially when they target producers (e.g., the electricity sector), are less likely to reduce inequalities as they poorly target the poor, and represent an opportunity cost in terms of forgone spending on health and education, which indirectly affects the poor the most.

Figure 4. Senegal: Factors of Prolonged Periods of Positive Growth

Factors of prolonged periods of positive growth off GDP per capita

Senegal performances during periods of positive growth vs. comparator countries



For each variable, the height of the figure shows the percentage increase in spell duration resulting from an increase in that variable from the 50th to the 60th percentile, with other variables at the 50th percentile, except autocracy, which is not a continuous variable. For autocracy, the figure shows the effects of a move from a rating of 1 (the 50th percentile) to 0 (the 73rd percentile.)
Source: Berg, Ostry, and Zettelmeyer (2008) and authors' calculations.

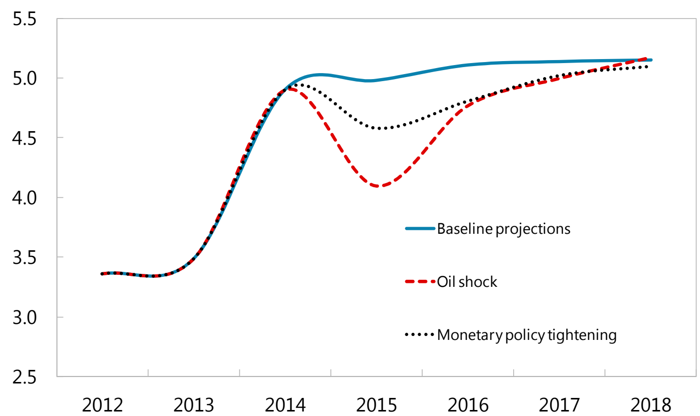
Source: IMF staff estimates.

15. Planning for contingencies will be critical, as potential risks to growth could complicate PSE implementation. Senegal faces risks to its growth pattern. An obvious risk relates to PSE implementation, and would require a timely implementation of reforms, so that the growth rebound materializes, thus creating the needed fiscal space for investment scale-up. But Senegal is also exposed to spillover risks, i.e. risks pertaining to the global economy and largely outside Senegalese control. Planning for these risks would be critical, as their potential impact on growth could derail PSE implementation. These risks can be quantified: based on the vulnerability exercise for Low-Income Countries (VE-LIC), Senegal could lose between ½ to 1 percentage points of growth (Figure)[10] This could result in increased tensions on fiscal balances, by reducing the fiscal space available for investment. Mitigating this risk requires planning and prioritization, so that investment spending (both human and physical) critical to the PSE would not be jeopardized. Such planning could be based on (i) streamlining public expenditure, for example by a timely implementation of the electricity sector reform, as it will also reduce the need for electricity subsidies, and (ii) maintaining prudent fiscal and debt policies, so that Senegal could preserve its access to financing in case of an adverse shock. On the latter, the credibility of fiscal deficit and debt objectives could be increased by adopting rules to contain recurrent spending growth and/or developing fiscal councils to enhance the effectiveness of fiscal objectives. Moreover, such actions should reduce the cost of access to capital markets, further increasing fiscal space for investment in human capital and public infrastructure.

Figure 5. Senegal: Vulnerability to Spillovers from the Global Economy

Real GDP Growth

(Percent)



Sources: Senegal authorities, and IMF staff projections.

10 Risks to the global economy are still on the downside. For Senegal the two critical sources of spillovers are (i) a tightening of monetary policy conditions in advanced economies, which would reduce demand for Senegal products, and (ii) an oil price shock, following the recent turmoil in the Middle East, which would translate into a decline in oil production and protracted increase in oil prices.

Annex: Identification of High Growth and High Debt Countries

High Growth Countries and Comparators

The list of 46 high growth countries is derived by from having an annual PPP per capita GDP growth rate of 5 percent or more between 1990 and 2013.[11]

From this list, the comparators are derived by applying the following additional filters:

1. The country had a GDP per capita in 2013 that Senegal could achieve over 30 years if the PSE succeeds in becoming an emerging market middle-income country (MIC), i.e. PPP per capita GDP between $5,500 and $9,800[12];
2. The country has lower PPP GDP per capita than Senegal in 1990, but has reached higher PPP GDP per capita than Senegal in 2013,
3. The country's export concentration is low (one third standard deviation below the mean) or has improved while remaining within two-third standard deviation above the mean.

Identification of Growth Episodes

From the list of high growth countries, growth episodes were identified using the following criteria:

1. Real GDP growth of 5 percent or more for at least 5 consecutive years.
2. No more than 2 years of deviations from growth trend within the 5 year period.

In figure 1, the variables are computed as follows: the value for "before episode" is a three-year average before the start of the episode while the value for "after episode" is a three-year average through the end of the growth episode.

High Debt Countries

The list of 43 high debt episode countries is derived by applying the following filter:

1. A country that experienced a growth in debt position of 2 percent per year consecutively for at least 5 years in trend, with no more than 2 years of deviations from trend consecutively within the 5 year period.
2. The country's debt position exceeded 40% of GDP at some point between 1990 and 2013.

[11] In the October 2013 Regional Economic Outlook (REO), IMF staff identified six nonresource-rich sub-Saharan African countries (Burkina Faso, Ethiopia, Mozambique, Rwanda, Tanzania, and Uganda) that achieved real output growth (in national currencies) of 5 percent or more and real per capita GDP growth of more than 3 percent during the period 1995-2010. The methodology used in this note differs from that used in REO in three ways: (i) time period used is 1990-2013; (ii) the series used to determine average growth is PPP real GDP per capita; and (iii) the cutoff is 5 percent.

[12] These are the lower and upper bounds if Senegal sustains an average annual growth rate of 4.6 percent and 7.6 percent. An exception is made for African MICs which have achieved a higher income level in 2013.

The variables reported in figure 1 for high debt countries, including Senegal, are computed as three-year averages before the start of debt episodes and through the end of the debt episode.

High Growth Countries

Equatorial Guinea	Korea, Rep.	Ireland	Lao PDR
China	Dominican Republic	Ethiopia	Sri Lanka
Bosnia and Herzegovina	Mozambique	Ghana	Turkey
Cabo Verde	Bangladesh	Armenia	Panama
Macao SAR, China	Albania	Uruguay	Middle income
Vietnam	Norway	Tunisia	Poland
Bhutan	Romania	Guyana	Indonesia
Chile	Singapore	Azerbaijan	Lebanon
Cambodia	Malaysia	Lesotho	Slovak Republic
Estonia	Mauritius	Hong Kong SAR, China	Mongolia
India	Trinidad and Tobago		Belarus
	Thailand		Uganda
	Peru		

Comparators: Growth Episodes

Country Episode	Begin	End		Begin	End		Begin	End		Begin	End
Cabo Verde	1993	2003	India	1994	2011	Sri Lanka	2005	2012	Uganda	1999	2013
China, P.R.: Mainland	1991	2013	Indonesia	1990	1997	Tunisia	NA	NA	Vietnam	1992	2007
Guyana	1991	1997	Mauritius	NA	NA						

Countries with High Debt Episodes

Country Episode	Begin	End		Begin	End		Begin	End		Begin	End
Antigua and Barbuda	1997	2004	Croatia	2008	2013	Jamaica	1999	2003	Serbia, Republic of	2008	2013
Bahamas, The	2001	2013	Cyprus	1995	2004	Lithuania	2008	2013	Seychelles	1990	2001
Barbados	1999	2013	Dominica	1997	2001	Macedonia, FYR	2008	2013	South Africa	2008	2013
Belarus	2005	2011	Egypt	2008	2013	*Malawi*	2007	2013	St. Kitts and Nevis	1996	2005
Benin	2006	2013	El Salvador	2008	2013	Malta	1995	1999	St. Lucia	1990	2005
Bolivia	2000	2004	Eritrea	2004	2008	Montenegro	2007	2013	St. Vincent and the Grenadines	1997	2005
Bosnia and Herzegovina	2007	2013	*Gambia, The*	2007	2013	Morocco	2008	2013	Suriname	1996	2000
Central African Republic	2000	2005	Grenada	1999	2013	*Niger*	2008	2013	Ukraine	2007	2013
Colombia	1996	2003	*Haiti*	1999	2003	Paraguay	1996	2002	Venezuela	2008	2013
Congo, Republic of	1990	1994	*Honduras*	2008	2013	Philippines	1998	2003	Yemen, Republic of	2008	2013
Costa Rica	2008	2013	Hungary	2001	2013	*Senegal*	2006	2013			

High debt episodes countries in italics have benefited from the Heavily Indebted Poor Countries Initiative (HIPC).

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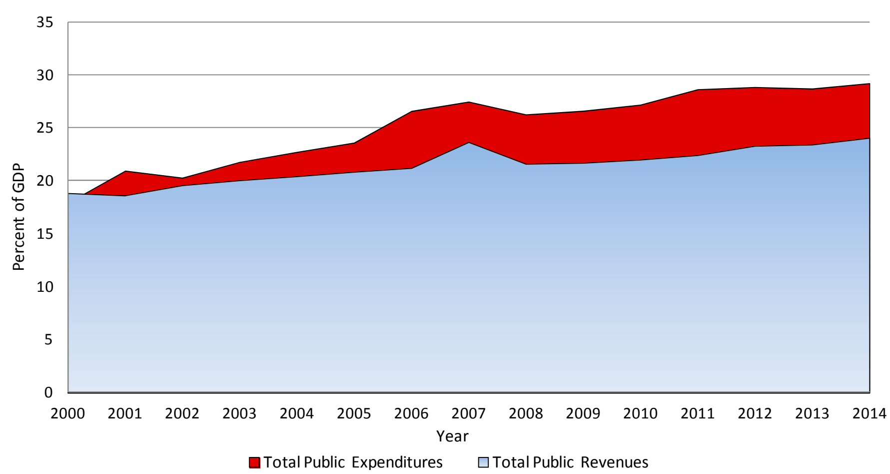
STRENGTHENING SENEGAL'S FISCAL FRAMEWORK[1]

The PSE relies on a new composition of public finances, which envisages raising additional revenues and rebalancing spending from current to capital. These plans contrast with the experience in Senegal throughout the last decade, characterized by weak revenue performance and substantial increases in public consumption, particularly the government's wage bill. In this context, strengthening the fiscal framework would be a key step forward to help steer public finances to support the PSE. This section highlights some areas for improvement, in particular in identifying fiscal challenges and planning a credible medium-term fiscal strategy.

A. Fiscal Performance during the Last Decade

1. **The growth of spending above revenues has weakened the sustainability of public finances.** The increase in public spending has not been accompanied by a parallel increase in public revenues (Figure 1), thus hampering public finances. As a consequence, the public deficit is at 5.2 percent of GDP in 2014 (up from less than 2 percent of GDP a decade earlier) and public debt is at 53.4 percent of GDP which was already high since the debt relief obtained under the HIPC initiative. While the authorities have committed to deficit reduction, spending continues to exceed revenues. Financing the deficit through increased public debt may prove increasingly difficult and more costly, as international markets are tightening credit conditions for emerging market economies.

Figure 1. Senegal: The Evolution of Spending and Revenues in Senegal, 2000-2014

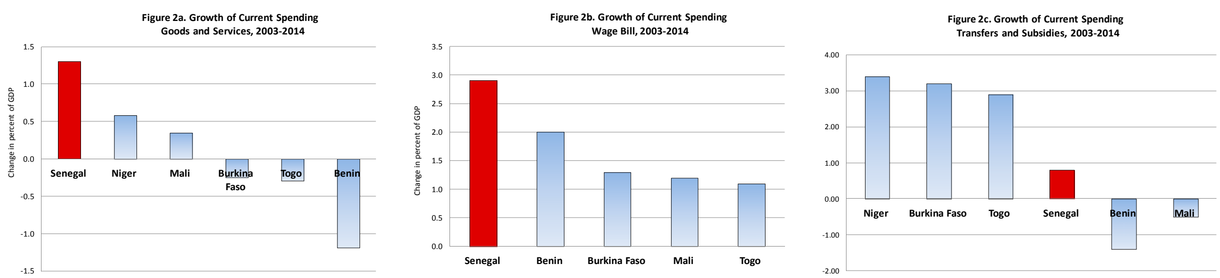


Source: IMF staff calculations.

[1] Prepared by Carlos Mulas-Granados (FAD) with contributions from Olivier Basdevant (MCD) and Renaud Duplay (FAD).

2. Current spending growth has been led by the wage bill and the consumption of goods and services. Between 2003 and 2014, overall spending increased by around 7 percentage points of GDP, from nearly 21 to 28 percent of GDP. This has been the third largest increase in the region and has placed Senegal among countries with the highest public spending levels in the WAEMU. In that period, current spending increased by 5 percentage points of GDP, driven by increases in the wage bill, other goods and services, and to a lesser, extent transfers and subsidies (Figure 2).[2]

Figure 2. Senegal: The Increase in Expenditure Items, 2003-2014

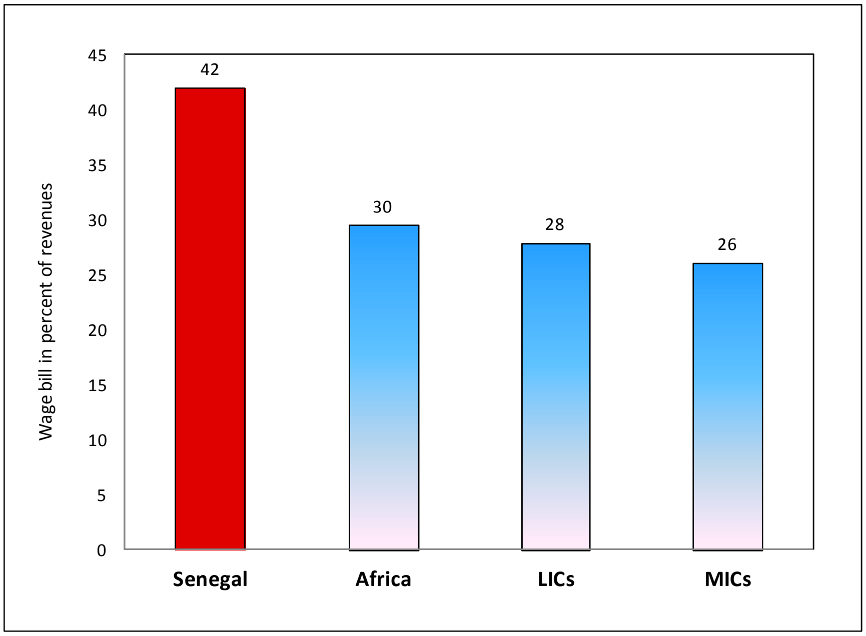


Source: IMF staff calculations.

3. The relatively high wage bill as a share of domestic revenue raises concerns about its sustainability. The consolidated wage bill in 2014 represents about 42 percent of domestic revenue, well above the average of 30.7 and 26 percent in Africa and low-income countries respectively (Figure 3). In addition, this ratio exceeds by a large margin the WAEMU convergence criterion ceiling of 35 percent of domestic revenues. While the size of the public workforce in Senegal (about 150,000 employees) is within international standards. The increase in the wage bill has almost entirely been driven by the use of wage supplements and allowances. Indemnities and other wage supplements surged in the last decade while the share of base salaries in the total wage bill declined substantially over the same period (Figure 4). Allowances are a key element to attract talent and promote a results-oriented performance management, but the sharp increase in allowances seems excessive in view of the modest record of sectoral reforms and macroeconomic performance during the past decade. Against the backdrop of recurrent revenue shortfalls, the large consolidated wage bill is an important source of concern.

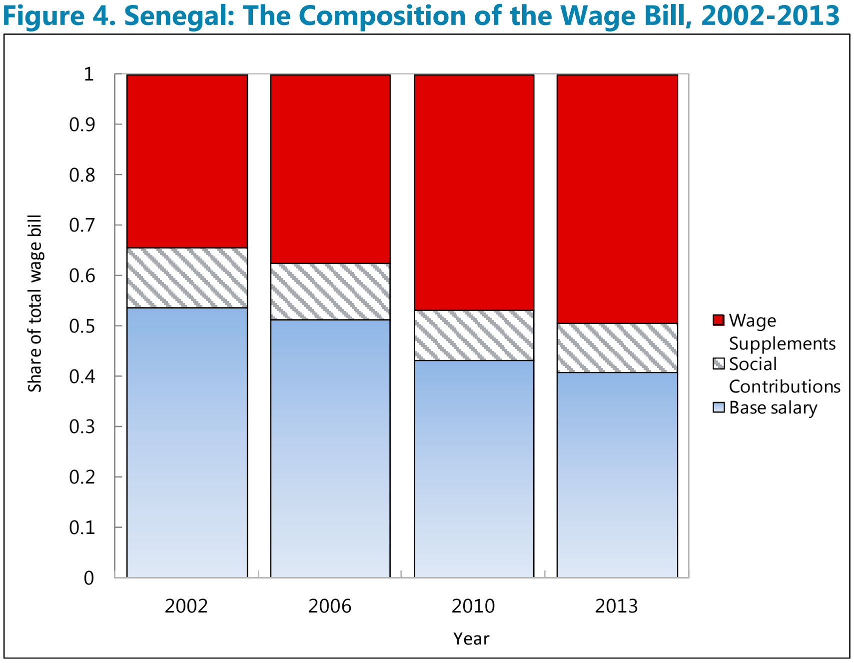
[2] The figures of current and capital spending used in this section are different from published budget figures, as they include a reclassification of current spending which was shown under the capital budget. This reclassification was done in collaboration with Senegalese authorities during a Technical Assistance mission on expenditure rationalization led by the Fiscal Affairs Department (IMF) in February 2014.

Figure 3. Senegal: The Wage Bill as a Share of Revenues, 2014



Source: IMF staff calculations.

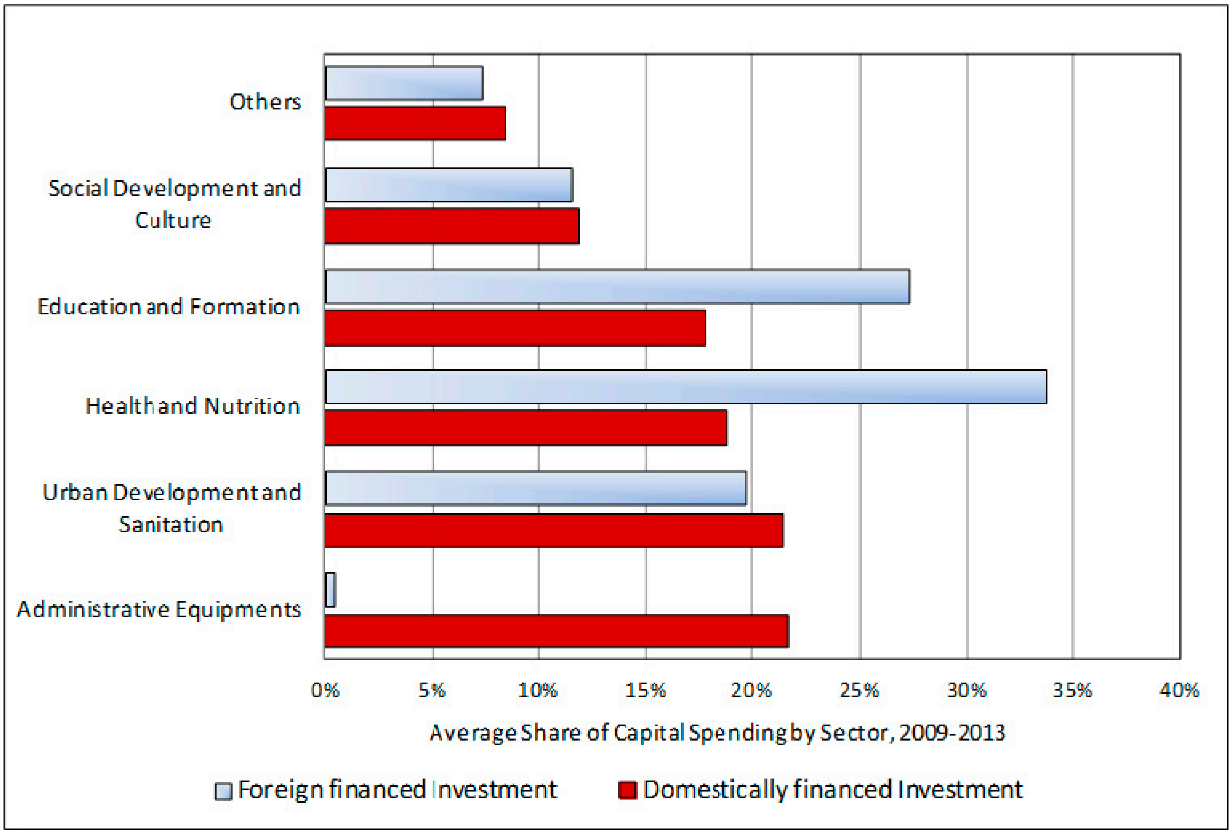
Figure 4. Senegal: The Composition of the Wage Bill, 2002-2013



Source: IMF staff calculations.

4. The capital spending in Senegal has increased substantially in the last decade. As a share of GDP, the capital spending budget almost doubled since 2008, reaching about 7 percent of GDP in 2014. Few autonomous agencies execute almost 80 percent of the capital budget. Most of the capital spending took place in the areas of urbanism and sanitation, transport infrastructures and social infrastructures for education and health. The composition, however, varied with the source of financing**.** For example, the domestically financed public investment was largely devoted to projects related to improve urban development and sanitation, while the externally financed investment projects were directed to ameliorate the education and health sectors. (Figure 5). The size of administrative spending financed by domestic resources is partially explained by the need to cover for operating expenses associated with development projects not financed by donors. This is an area for potential savings.

Figure 5. Senegal: The Composition of Capital Spending, 2009-2013

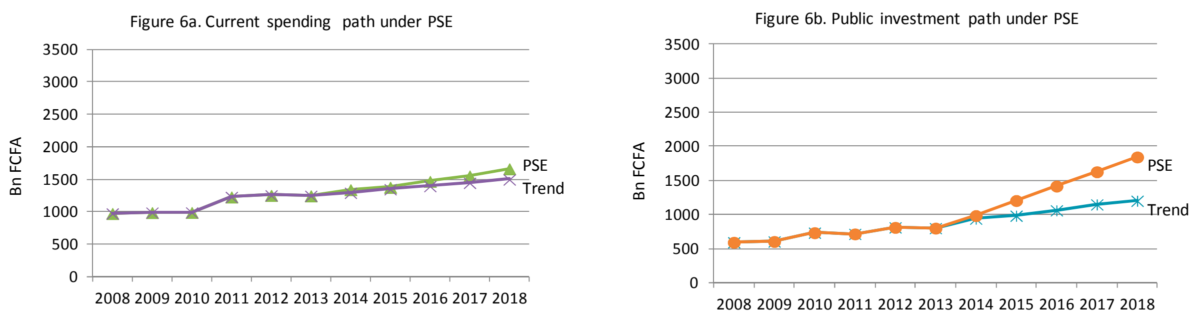


Source: IMF staff calculations.

B. Challenges for Public Finances under the PSE

5. The PSE requires a stronger revenue performance and a new composition of spending. The fiscal projections included in the PSE for the period 2014 to 2018 aim at increasing public revenues at an average rate of 12.4 percent, and increasing expenditures more slowly at an average rate of 10.2 percent. In perspective, this means that public revenues are expected to increase moderately following their recent trend, but current expenditures will have to grow only at the rate of GDP, which would imply a freeze in real terms. In this context, the PSE plans to accommodate a major increase in public investment between 2014 and 2018, clearly departing from trend projections (Figure 6).

Figure 6. Senegal: Public Spending Composition Under the PSE, 2014-2018



Source: Senegalese authorities, IMF staff calculations.

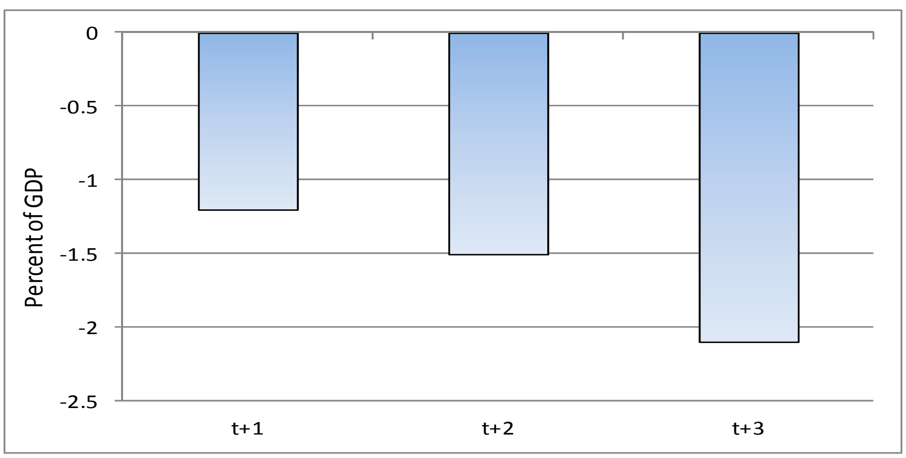
6. **Under the PSE, public spending should be more efficient to maximize its impact on economic growth.** While Senegal has been one of the countries with a higher than average level of public spending in the region, average GDP growth in the last decade has been below the WAEMU and LICs averages. Countries like Niger, Benin, Mali or Burkina Faso have attained higher average growth rates, while maintaining lower public expenditures to GDP levels. Two factors may explain this apparent inefficiency of public spending in Senegal. On one hand, the composition of public spending, as classified in the budget, does not reflect the true size of productive spending, which is significantly lower than the headline numbers show. On the other hand, poor planning of public investment has hampered their impact. This reflects insufficient attention to the economic and social costs- benefit analyses through serious feasibility studies. These problems are compounded by poor execution of the capital budget due to a weak public investment management system leading to low efficiency. The consequence of these deficiencies is a poor linkage between spending and economic growth.

7. **The PSE requires a better classification of spending.** PSE initial projections were based on a classification of spending which mixes current and capital expenditures, and misclassifies part of the wage bill. In principle, the Senegalese budget system classifies current and capital spending in clearly separated chapters, but certain important budget items are mixed. Under the standard classification, current expenditure represented 60 percent of the budget in 2013, and capital expenditure represented the remaining 40 percent. With a proper classification, the shares are quite different. After reclassifying budget execution by nature of spending, in 2013, public consumption amounted to 77 percent of total outlays, and capital expenditures represented only 23 percent. If salaries of contractual teachers, the wage bill of public entities (agencies, universities and hospitals) and the salaries paid under the investment budget executed by the State are added to the remuneration of central government employees, the wage bill increases by 45 percent. Similarly, total consumption of goods and services is actually 46 percent higher when the operating costs of agencies, universities, hospitals and investment projects are added to the use of goods and services by central government ministries. In this context, the

government has begun a gradual process to reclassify spending properly from the 2015 budget law onwards.

8. The PSE needs better budget planning and execution. The PSE assumes that budget projections and execution would evolve together, but this has not been the case in the recent past. This needs to be addressed if spending under the PSE is to have the desired economic impact. Since 2010, the authorities' fiscal projections have been consistently overoptimistic. According to Mauro (2011) the average difference between the approved budgets and their outcomes in Senegal has been around -1 percent of GDP until 2010, and the deviation of the primary balance could reach up to -2 percent of GDP in the subsequent years (Figure 7). This problem became more pronounced in the recent period between 2010 and 2013. The difference between program projections at the beginning of every year and actual year-end outcomes has been especially important in the case of revenues, reaching up to 1.2 percent of GDP in 2013. These deviations have also been very important in the case of capital expenditures, reaching close to 0.7 percent of GDP. To preserve the deficit targets, revenue underperformance has been systematically offset by reductions of capital expenditures. This is the reverse of what is required to support economic development, which requires that investment projects are executed in a timely manner to maximize their economic impact. If the PSE is to succeed, such budget practices will need to be improved to maximize the economic impact of projected investment.

Figure 7. Senegal: Differences Between Approved Budget and Outcomes



Source: IMF staff calculations based on Mauro (2011).

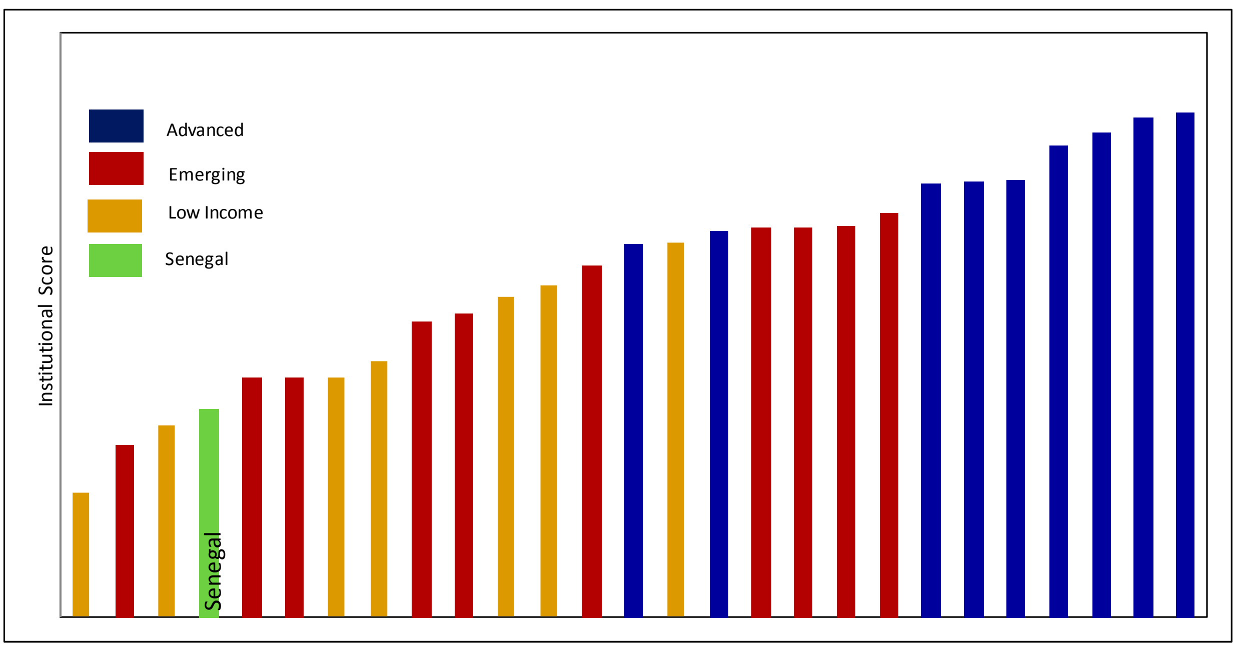
C. Strengthening Senegal's Public Finances and Its Fiscal Framework

9. Substantive action should be taken to improve the composition of public finances. Additional fiscal space could be secured by increasing revenues, particularly collecting tax arrears. In addition, public consumption should be frozen in real terms through additional efforts to contain the wage bill, rationalize spending on goods and services, and reduce subsidies to the electricity sector. Subsequent savings could thus be invested in improving human capital and public infrastructure as a means to increase the growth potential of the economy.

10. Budget institutions could help restore fiscal sustainability and improve the efficiency of spending. In this context budget institutions are defined as the structures, rules, and procedures that govern the formulation, approval, and execution of government budgets. These institutions include arrangements for understanding the government's fiscal position, developing a credible consolidation plan, and implementing that plan through the budget process. Recent evidence (IMF, 2014) suggests that countries with comprehensive fiscal reporting, forecasting, and risk disclosure seemed to have a better assessment of their post-crisis fiscal position and prospects. Those with more credible medium-term frameworks, performance budgeting systems, and intergovernmental fiscal arrangements were quicker to announce their adjustment plans and better at protecting public investment within those plans. Finally, countries with more unified and disciplined budget processes tended to implement their plans more effectively.

11. Twelve budget institutions were identified by the IMF as crucial for achieving sustainable public finances and more efficient public spending. These twelve institutions can be grouped in three larger policy areas: (i) understanding the scale and scope of the fiscal challenge; (ii) developing a credible fiscal adjustment plan; and (iii) implementing the plan through the budget process. These institutions and their key design features provided the basis for a 48 questions survey that was completed in cooperation with the Senegalese authorities. The results show that Senegal ranks low in the aggregate ranking of budget institutions, in the lower quartile (Figure 8).

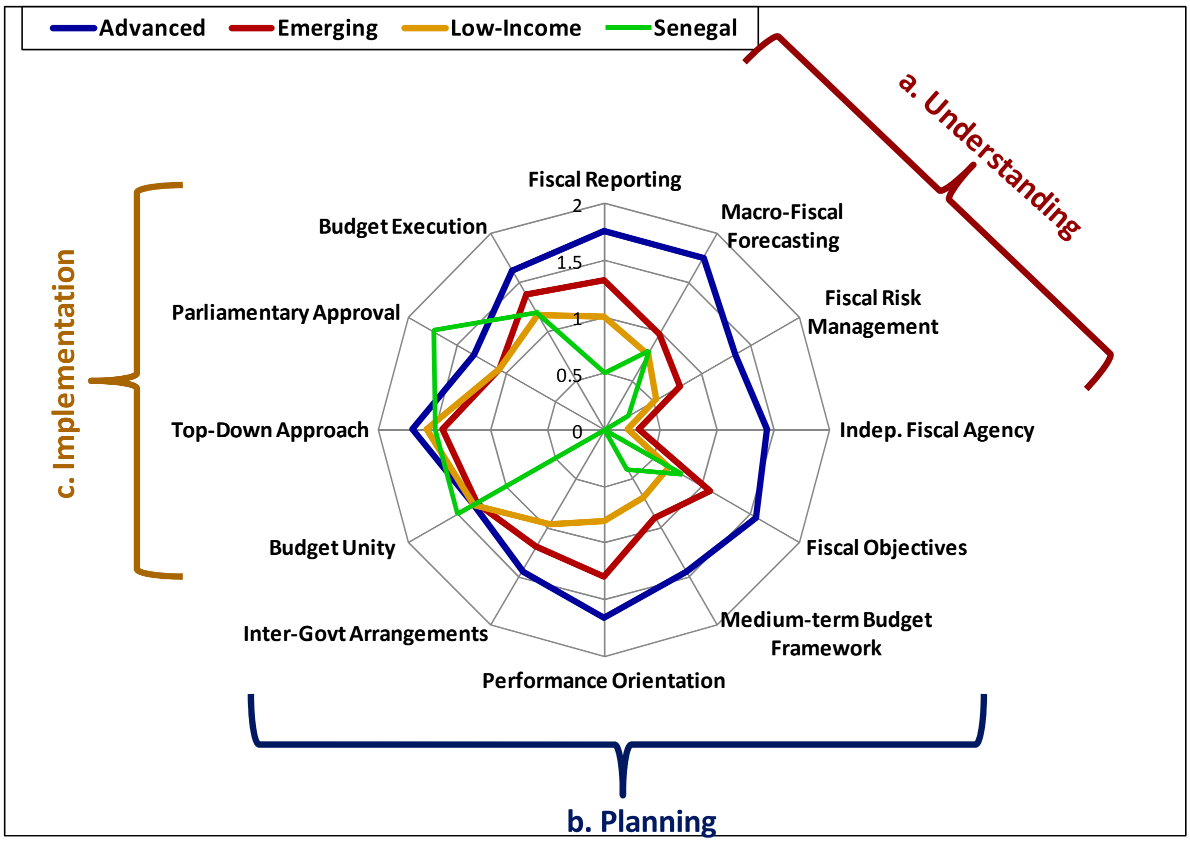
Figure 8. Senegal Overall Index of Budget Institutions



Source: IMF staff calculations.

12. Senegal has the capacity to improve the credibility of its budget. Senegal scores low in assessing fiscal challenges and planning a credible budget, but scores high in the capacity to implement the budget. In particular, Senegal could improve its assessment of the fiscal situation through more comprehensive and timely fiscal reporting, more transparent macro-fiscal forecasts, and greater analysis of fiscal risks. In addition, the credibility of fiscal adjustment plans could also be supported by better designed medium-term frameworks, greater use of expenditure reviews, and stronger intergovernmental fiscal coordination. The single dimension where Senegal stands out from international comparators is in the capacity to implement the budget (Figure 9). But execution of the budget could be strengthened further through tighter controls over supplementary budgets and multi-year spending commitments.

Figure 9. Senegal Components of the Index of Budget Institutions



Source: IMF staff calculations

13. The public investment management system could also be strengthened. Several measures could help generate better value for public money. In the short term, the linkages between the PSE, the macroeconomic framework, and the sectoral strategies of the ministries should be strengthened. In addition, the method to calculate the execution rate of investment should be revised and strict limits introduced to reduce unexpected changes in the composition of public investment. Most importantly, a proper appraisal mechanism is needed to enhance project selection, including systematic application of cost-benefit analysis for large projects. Finally, projects need to be better classified and integrated in a new comprehensive database, in order to enhance the monitoring of new investment.

D. Conclusions and Recommendations

14. Fiscal performance should be enhanced to guarantee the sustainability of public finances. The recent trajectory of fiscal consolidation should continue. Maintaining the commitment to a medium-term deficit target below 4 percent of GDP is fully compatible with the implementation of the PSE. Revenues should keep gaining ground once the tax reform has been implemented while overall expenditures should only grow more moderately. The debt-to-GDP ratio should be kept constant and new investment projects associated with the PSE should be financed with additional revenues or with a reallocation of spending.

15. Improving the composition of the budget could help the PSE succeed. The impact of public spending on growth depends on the cyclical effect of public consumption in the short term and the efficiency of public investment in the medium term. In this context, the ongoing reclassification of spending should continue, as it will help identify areas where savings could be made and programs which should be reinforced. Freezing public consumption, by reducing the growth of the wage bill and cutting unproductive spending, is a crucial aspect of the strategy to gain fiscal space needed to finance additional PSE related investments. At the same time, the central government should accelerate the reform of the agencies, gain control over transferred funds and make sure that a growing number of their activities are aligned with the objectives of the PSE.

16. The quality of public finances could be reinforced through stronger budget institutions. By improving fiscal data and fiscal reporting, Senegal could ameliorate macro-fiscal forecasting and reduce fiscal risks. In addition, fiscal objectives should become more realistic and be embedded in a medium-term budget framework fully consistent with PSE objectives. Program-based budgeting is a crucial reform that would help maximize the economic impact of public finances. In particular, the reform of the public investment management system should be geared towards increasing the number of projects that are fully implemented in a timely and cost-effective manner, especially those related to the PSE. All these actions should be part of a concerted effort to better link the assessment of fiscal challenges with budget planning and implementation.

References

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Mauro, P., 2011, *Chipping Away at the Public Debt—Sources of Failure and Keys to Success in Fiscal Adjustment* (Hoboken: N.J.: John Wiley and Sons).

EXTERNAL STABILITY[1]

Senegal has continued to record sizeable current account deficits over the past decade, financed mainly by official flows, but with increasing recourse to private flows. While official WAEMU reserves are currently adequate and Senegal's exchange rate shows no significant signs of misalignment, the current account deficit is large, at around 10 percent of GDP, and there are signs of eroding competitiveness. Senegal's exports have not gained market share and survey-based indicators continue to point to a need for strong measures to improve structural competitiveness and the business environment. Debt remains manageable, but there is little room for higher fiscal deficits or more non-concessional borrowing if Senegal's current low risk rating is to be preserved. Given these external vulnerabilities, pro-growth fiscal policy must proceed with caution, especially in the fixed exchange rate context where almost all the weight of policy responses is placed on the budget.

A. Current Account and Senegal's Twin Deficits

1. Senegal's main external risk is the current account deficit,[2] which is now over 10 percent of GDP. Over the past decade, the current account deficit has averaged about 8.6 percent of GDP, with overall fiscal balances averaging -4.4 percent of GDP. The current account deficits have been financed mainly by grants and government borrowing (particularly project loans). Senegal is also increasingly resorting to non-concessional commercial borrowing, which exposes it to shifting donor and market sentiment. Although the deficit is projected to decline in the long term with fiscal consolidation, it will remain high in the medium term, at over 8 percent of GDP. The regional nominal effective exchange rate has appreciated by about 6 percent since the first quarter of 2013, mirroring euro appreciation. However, the real effective exchange rate has appreciated more moderately by about 4 percent owing to low inflation. It remains broadly in line with fundamentals, with Senegal's investment/savings gap roughly equally shared by the public and private sector.

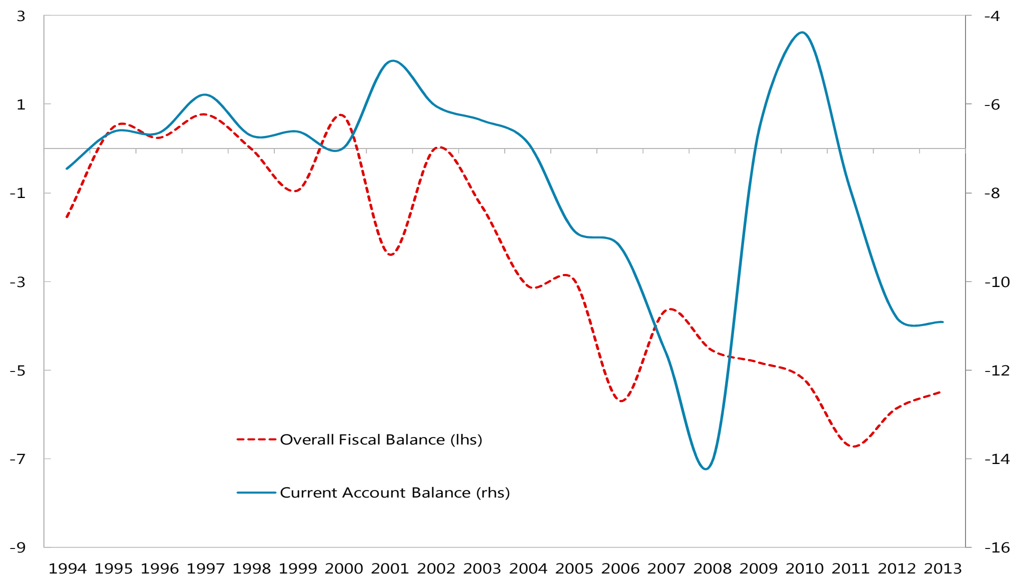
2. The experience in Senegal is consistent with the theory that shocks in the government budget move the current account in the same direction. From the time of the CFA franc devaluation in 1994 until 2000, Senegal maintained tight fiscal policies, with strong improvements in the central government's fiscal position. After several years of deficit, the fiscal balance showed surpluses above 1.5 percent of GDP between 1996 and 1999. The external current account deficit (excluding official transfers) also declined slightly between 1996 and 1999. Between 2001 and 2008, fiscal and external imbalances grew, culminating in 2008 with a shock to the balance of payments of 5¼ percent of GDP owing to the impact of rising food and energy prices on the import bill. As a response to the price increases, the government introduced a number of untargeted subsidies, which together with other higher expenditure and lower tax revenues widened the overall fiscal deficit to 5.1 percent of GDP in 2009 from 3.7 percent of GDP two years earlier. In 2009-10, the external and fiscal balances moved in different directions, but

[1] Prepared by Gillian Nkhata.

[2] Current account excluding grants.

fiscal developments in 2012 and 2013 were again accompanied by a widening current account deficit (Figure 1).

Figure 1. Senegal: Current Account and Fiscal Deficit (Percent of GDP)



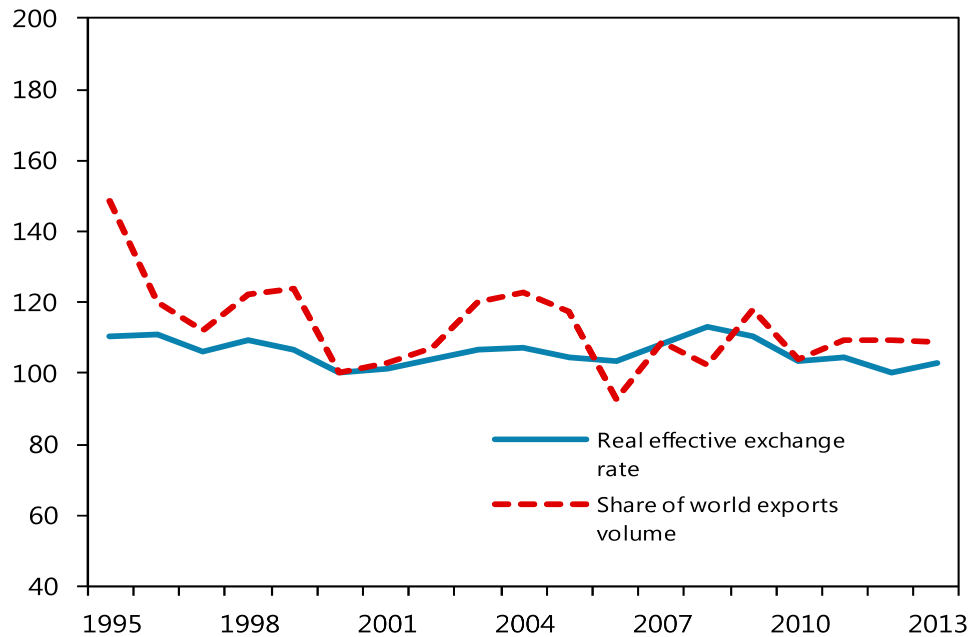
Source: IMF staff estimates.

3. The observed correlation between Senegal's deficits has clear policy implications. The analysis suggests that for Senegal, excessive deficit spending can result in large external imbalances. Senegal's current account deficit will remain high in the medium term, reflecting mainly higher imports associated with infrastructure projects, although it is projected to decrease in the long-term to around 8 percent of GDP. The low savings, especially in a context of large investment needs under the PSE, could mean continued deficits over the medium term, which may become difficult to finance. This means that budget deficits must remain contained within reasonable limits, even in an ambitious investment-led strategy. In addition, fiscal prudence must be accompanied by measures to improve the productivity of public and private investment. The current weaknesses in public investment management and the business environment suggest that there is ample scope for substantial gains.

B. Export Performance

4. Senegal's export climate suggests a much greater potential for export growth than has been realized to date. The country enjoys a favorable geographic location, with a major seaport and easy access to the large European and North American markets. In addition, it has the benefit of a stable regional currency and a political environment with democratic institutions. The country also offers a relatively competitive export framework, including no taxes on exports, low shipping costs, easy repatriation of capital and income, abundant semi-skilled and unskilled human resources, and a relatively robust telecommunications infrastructure. Senegal is also a party to a range of agreements that provide it with privileged market access, including bilateral agreements with several large economies (in particular China and the United States), and is also signatory to the Cotonou Agreement, which provides (reciprocal) duty-free access to EU markets for African, Caribbean and Pacific country exports.

Figure 2. Senegal: Export Performance and Exchange Rate (index 2000=100)



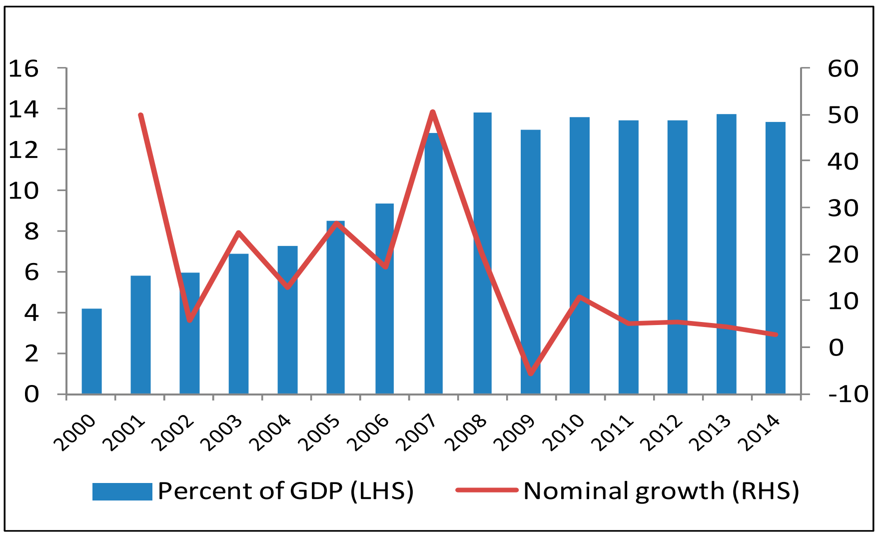
Source: IMF staff estimates.

5. Despite the country's relative strengths, Senegal's exports are not gaining significant market share or increasing as a percentage of GDP. Senegal's global market share has barely increased over the past decade (Figure 2), while the contribution of exports to GDP has remained around 25 percent. In addition, while Senegal has a relatively diversified export basket compared to its peers, the main goods remain dominant, as do the export destinations. Senegal's exports are also more concentrated on lower value added products, which exposes it to tougher competition on the global markets. The UEMOA region the primary destination for Senegal's exports (32.5 percent of the total in 2012). The European Union is the second, with almost 26 percent of the total in 2012). This is followed by Asia, whose share was 22 percent in 2012, while North America still accounts for less than 1 percent of the total. The top five country destinations in 2012, which accounted for almost 55 percent of total exports, were Mali (19.3 percent), Switzerland (12.8 percent) and India (12.6 percent), followed by Guinea (5.3 percent), and France (4.9 percent). This high concentration makes Senegal particularly vulnerable to shocks in the EU, as evidenced by the impact during the global financial crisis. Going forward, production at a zircon mine and the revival of the chemicals industry are expected to boost exports, beginning in 2015. In addition, there are signs of increasing diversification across export partners, mainly in favor of Asian countries, whose share has more than doubled since 2007.

C. Foreign Direct Investment and Remittances

6. Senegal also lags behind its comparators in attracting foreign direct investment (FDI). Inward FDI averaged about 1 percent of GDP from 2000-2005, but rose above 2.0 percent in 2006-07. For the past five years, net FDI inflows have remained at an average of around 2 percent of GDP, compared to over 7 percent of GDP on average in other lower-middle-income Sub-Saharan African (LMI SSA) countries, as classified by the World Bank.[3] There are few real legal barriers to foreign investment. The Senegalese Investment Code provides equitable treatment of foreign firms. It also offers tax holidays and tax-free export processing zones. There are few barriers regarding total ownership of businesses by foreigners. However, Senegal continues to rank among the lowest in the World Bank ease of doing business survey (see below)**.** The main constraints include access to credit, cumbersome procedures, enforcement of contracts, property rights, and constraints in obtaining long-term credit from commercial banks.

Figure 3. Senegal: Worker's Remittances



Source: IMF staff estimates.

7. Remittances continue to be an important and stable source of foreign exchange, averaging around 12 percent of GDP since 2008. Workers remittances have been robust over the past decade, both nominally and as a percentage of GDP (Figure 3). They have averaged around 12 percent of GDP since 2007, contributing nearly as much as half of exports of goods and services, and over four times FDI inflows. Senegal is now among the top four recipients of remittances as a percentage of GDP in Sub-Saharan Africa (after Lesotho, Togo, Cape Verde, and Guinea-Bissau). In nominal terms, remittances have increased continuously, with the exception of 2009, when they

[3] Other lower-middle-income Sub-Saharan African countries included in the comparison were Cameroon, Cape Verde, Republic of Congo, Cote d'Ivoire, Ghana, Lesotho, Nigeria, Sao Tome and Principe, Swaziland, and Zambia.

declined by 6.7 percent during the global financial crisis. This decline was modest compared to the drop in FDI inflows in the 2009-10 period (25 percent). Remittance flows are also significant as a share of reserves, amounting to 72 percent in 2013.

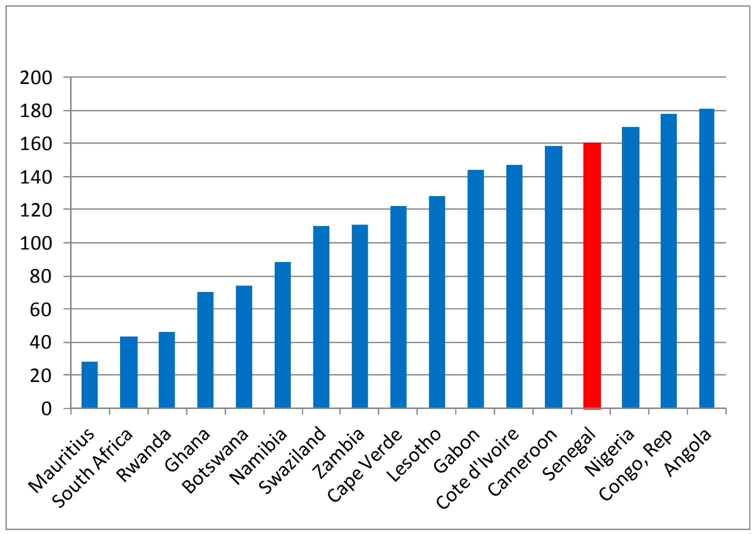
D. Structural Competitiveness

8. Senegal's competitiveness depends critically on improving the business environment. Although Senegal has taken steps in recent years to improve the business environment, a number of competitiveness indicators suggest that much more needs to be done. According to various surveys, the business environment is notably hampered by poor investor protection, cumbersome procedures for paying taxes and registering property, inadequate supply of infrastructure, difficulty accessing financing, and corruption.

9. In the 2014 edition of the World Bank's Doing Business report, Senegal ranks 178 out of 185 countries (Figure 4). It has fallen two places since the last survey in 2013, and is now below the WAEMU average (168). Its worst rankings (182) are in the getting electricity and paying taxes categories. Other categories where Senegal scores poorly include registering property (174), protecting investors (170) and enforcing contracts (167). Senegal ranks below most other lower- and upper-middle-income Sub-Saharan countries (Figure 4).

Figure 4. Senegal: Ease of Doing Business, 2013

World ranking out of 185 countries

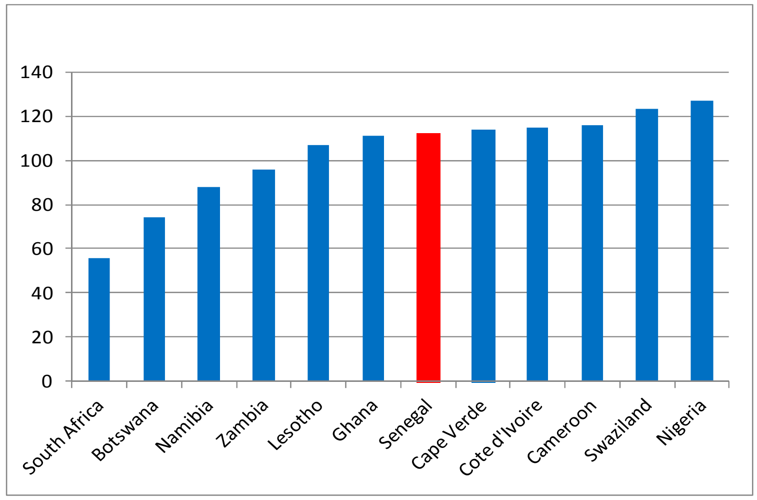


Source: World Bank.

10. The World Economic Forum ranked Senegal 112th in 2014-15 out of 142 countries (Figure 5). Areas in urgent need of attention include health and basic education, for which Senegal ranks 131st. According to the report, only three out of four children receive primary education and communicable diseases continue to erode the health of the general population. Higher education and training (119th place) are also in need of significant improvement, while infrastructure requires significant upgrading (111st place). The report also views Senegal's macroeconomic environment as challenging, ranking it 97th, mainly because of the high government deficit. Senegal scores better on national institutions (74th) rank, with signs of steady improvement across a range of other indicators. The report also recognizes Senegal's relatively efficient goods and labor markets (68th place). Senegal also fares well regarding the red tape to start a business, which is judged to be low, even by international comparison (six days and four procedures) (22nd place).

11. Senegal's government effectiveness, as measured by the World Bank's Governance Indicators, is slightly below average compared to lower- and upper-middle-income Sub-Saharan countries, and has been trending downward over the past decade. By several measures, corruption remains a problem. The World Economic Forum identifies corruption as the second most problematic factor for doing business in Senegal. Transparency International ranks Senegal 112 out of 182 countries in its 2011 Corruption Perception Index. Based on the World Bank's Governance Indicators, corruption in Senegal is worse than average lower- and upper-middle-income Sub-Saharan countries.

Figure 5. Senegal: Global Competitiveness Index
(2013-2014, World Ranking out of 142 Countries)



Source: World Economic Forum.

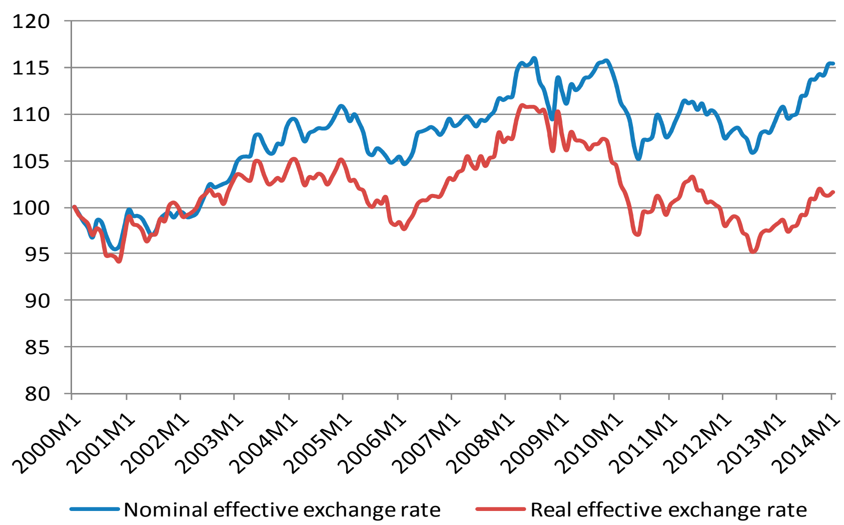
E. Price Competitiveness

12. The assessment of real effective exchange rate (REER) at the regional level does not suggest any significant price-competitiveness issues. The REER was assessed using three complementary methodologies developed by the Consultative Group on Exchange Rates (CGER). Although the regional effective nominal exchange rate appreciated by about 4.6 percent since the beginning of 2013, reflecting the euro appreciation, the real exchange rates appreciated only by 2.5 percent, owing to moderate inflation developments in the region. Senegal experienced a moderate REER increase (by about 4 percent), but model-based assessments do not point to significant misalignments of the real effective exchange rate.

Macroeconomic Balance Approach

13. The macroeconomic balance approach calculates the difference between the current account balance projected over the medium term (the "underlying" current account) and an estimated current account "norm" based on projected values of medium-term economic fundamentals. The exchange rate adjustment that would eliminate this difference over the medium term is then calculated using an estimated elasticity of the current account with respect to the real exchange rate. Senegal's current account norm is calculated to be between -5.6 and -6.5 percent of GDP, based on coefficients estimated by Vitek (2012) and Lee et al. (2008). Assuming a trade balance elasticity of -0.71 for small countries, the difference between the underlying current account and the current account norm indicates a possible REER misalignment between -4.2 percent and 0.0 percent.[4]

Figure 6. Real and Nominal Effective Exchange Rates (Index 2000=100)



Source: IMF.

Equilibrium Real Exchange Rate Approach

14. The equilibrium real exchange rate approach directly estimates an equilibrium exchange rate as a function of medium-term fundamentals. The exchange rate adjustment needed to restore equilibrium over the medium term is then calculated as the difference between the estimated equilibrium real exchange rate and its current value. In the case of Senegal, the REER at end-2011 seems to be 8.5 percent below its estimated equilibrium value.

External Sustainability Approach

15. The external sustainability approach calculates the difference between the underlying current account balance and the balance that would stabilize net foreign assets (NFA) at some benchmark level. Using the same elasticity as in the macroeconomic balance approach, the exchange rate misalignment is equal to the adjustment necessary to bring the underlying current account in line with its NFA-stabilizing level. The current account balance necessary to stabilize Senegal's NFA-to-GDP ratio at its 2010 level (-48 percent) is estimated to be -3.4 percent compared to an underlying current account of 6.0 percent. Applying a trade balance elasticity of -0.71 implies a possible 3.2 percent REER overvaluation.

[4] See Tokarick (2010).

F. Reserve Adequacy

16. Official reserves coverage appears adequate by traditional metrics. Reserves are pooled among WAEMU countries, and therefore reserve adequacy must be assessed at the regional level. Regional official reserves are projected to decrease from CFAF 7051 billion (US$13. 8 billion) at end-2012 to CFAF 6886 billion (US$13.9 billion) at end-2013. Reserves coverage remains adequate at 4.7 months of next year imports, 50 percent of broad money, and about 91 percent of short-term liabilities. An alternative analysis based on cost-benefit analysis (Dabla-Norris et al., 2011) indicates that the reserves level is at the low end of the *optimal* reserves range which varies between 5 to 10 months of imports depending on the interest rate differential with the rest of the world.

G. Debt-Related Risks

17. Senegal's total public debt and external debt ratios have both increased substantially over the past five years. The ratio of total public debt to GDP amounted to about 47 percent in 2013, up from around 25 percent in 2008. At the same time, the stock of total external public and publicly guaranteed debt has increased from around 20 percent of GDP in 2008 to just over 32 percent at end-2013. These levels are close to those that prevailed before Senegal benefited from debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006. Debt servicing costs have also increased, reflecting higher recourse to market financing. External public debt service has increased from 4.3 percent of exports in 2008 to about 9 percent in 2013.

18. In terms of composition, the bulk of Senegal's public debt remains largely external and provided on concessional terms, but the use of financial market instruments is increasing.[5] Most of the public debt is external (i.e., owed to non-residents of the West African Economic and Monetary Union, WAEMU), however the share of domestic debt-to-GDP has increased from 5.3 percent in 2008 to around 16 percent in 2013.[6] Almost two thirds of Senegal's external debt is owed to multilateral creditors—primarily the World Bank and the African Development Bank. The largest groups of bilateral creditors are the OECD and certain Arab countries. The share of market debt is still relatively small, although it has grown rapidly over the past few years with the issuance of two Eurobonds in 2009 and 2011, and the contracting of a syndicated loan in 2013, which includes a tranche in euro targeting nonresidents. The authorities postponed a planned Eurobond issuance in 2013, following a sharp tightening of financial conditions on international markets during the course of the year. They then issued a US$500 million Eurobond in mid-2014. Conditions have been relatively favorable in international markets throughout the past few months, and the authorities got a rate of 6.25 percent, a little higher than the 6 percent yield on the 2011 Eurobond. This rate was higher than expected at the time of the previous DSA, partly owing to market concerns about the slow pace of reform, but more favorable

[5] Public debt refers to the debt of the central government.

[6] Domestic debt includes debt issued in the WAEMU financial market.

than might have been achieved in 2013. However, part of the proceeds was used to repay the euro tranche of the syndicated loan contracted in 2013, which has a shorter maturity and higher rate (6.5 percent).

19. Private external debt has averaged about 20 percent of GDP over the last decade and was estimated at about 36 percent of GDP at end-2013. [7] About half of this debt was in the form of trade credits and bank deposits; the rest consisted of debt securities, loans, and other liabilities. This exposure was partly offset by private external assets amounting to 8 percent of GDP.

20. Senegal remains at a low risk of debt distress. Under the baseline scenario, which is consistent with higher program ceilings for non-concessional and semi-concessional borrowing, all the debt burden indicators remain below their policy-dependent indicative thresholds, and debt ratios in present value terms are lower than in the previous debt sustainability analysis (DSA). Policy-dependent thresholds were increased as Senegal was reclassified to 'strong' performer based on higher average CPIA score in 2011-2013.[8] The probability approach also shows a more favorable outlook. The stress tests result in two spikes in debt service to revenue ratio, corresponding to the repayment of two Eurobonds, which result in a small and temporary breach of the threshold. The DSA, however, suggests that there is not much space for higher fiscal deficits if the low risk rating is to be preserved. It also indicates a need for caution in resorting to non-concessional borrowing.

Text Table 1. Total External Debt, Central Government

	(Percent of GDP, as of end of year)						% of total
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2013**
Total	19.6	26.8	27.3	27.4	31.0	32.4	100.0
Multilateral creditors	12.0	17.5	18.1	16.5	19.0	20.7	63.7
IDA/IBRD	7.0	8.0	8.0	8.8	9.2	9.6	29.6
AfDB/AfDF	1.5	2.2	2.5	2.9	3.0	3.6	11.0
IMF	0.5	1.8	2.9	0.0	1.9	2.4	7.4
OFID/BADEA/IsDB	1.7	3.2	2.7	2.8	2.6	2.6	8.0
EIB	0.2	0.3	0.3	0.3	0.2	0.3	0.8
Others	1.2	2.0	1.8	1.7	2.1	2.2	6.8
Bilateral creditors	7.6	7.9	7.6	7.2	8.1	0.1	26.2
OECD countries	2.2	2.7	2.6	2.1	3.2	3.3	10.1
Arab countries	4.1	3.8	2.8	2.2	2.1	2.0	6.1
Others	1.2	1.3	2.1	2.3	2.8	2.8	8.8
Commercial creditors	0.0	1.5	1.6	3.7	3.5	3.3	10.1
Memorandum Item							
Nominal GDP (CFAF billions)	5994	6050	6395	6775	7165	7308	

Sources: Senegalese authorities and IMF staff estimates

[7] Estimates of private sector external debt are based on BCEAO data on the international investment position.

[8] Senegal's CPIA score was 3.825 in 2013, and on average 3.81 over 2011–13. Under the debt sustainability framework rules, this corresponds to a "strong" performance.

21. Global financial conditions warrant close monitoring, as they could affect Senegal's access to financial markets. The normalization of monetary policy in advanced economies and the re-pricing of emerging market risks may eventually spillover to frontier markets like Senegal. In particular, it could result in either lower appetite for Senegalese securities, an increased risk premium, and an adverse effect on Eurobond terms and issuances for frontier markets like Senegal. To date, the impact of global tightening financial conditions has not yet had a significant impact on interest rates for Senegal. On sovereign bonds, the 2011 Eurobond yield has remained stable. More generally, there have been no visible increases in the interest rates on the regional financial market, which is not significantly integrated with international markets.[9] Against this background, the uncertain outlook in the global economy discussed in the first section could also eventually affect risk perceptions regarding Senegal.

H. Reforms to Achieve Higher Exports

22. Senegal is well positioned to become a primary trade hub for West Africa, but more is needed to achieve the export growth required to reach the PSE objectives. Senegal has several competitive advantages: political stability, government commitment, good road networks, a major port, and a competitive exchange rate arrangement. It is also one of the most industrialized countries in the region, and has favorable investment ratings.[10] However, experiences in other countries suggest that while access to international markets and a competitive price environment are crucial, Senegal would be in a better position to leverage its advantages, if it improved significantly its structural competitiveness and macroeconomic environment. This would imply action on several fronts.

- ***Maintain sound and credible macroeconomic policies.*** With Senegal in a currency union and a regional exchange rate broadly in line with fundamentals, fiscal policy and structural measures are the only levers available to boost competitiveness. Changing the equation will require strong actions to increase net national savings by cutting back on fiscal deficits, but also by stimulating household savings. Sound fiscal policies will provide the government with greater degrees of freedom to implement policies to boost exports. Credible policies overall will attract the type of investment needed to develop a more diversified and upgraded export basket.

- ***Boost foreign direct investment inflows.*** Empirical evidence suggests that FDI can enhance export performance, in particular, by introducing innovations and transforming the composition of exports (China, Singapore). It also shows that the impact of FDI on export growth varies with the development of the export sector. The impact is strongest at the earliest and the most advanced

[9] For example, Senegal debt is held mainly by WAEMU residents, with little foreign ownership. Further, the transmission mechanism from the policy rates to lending rate remains weak and hampered by shallow and segmented financial markets.

[10] Senegal's Standard & Poor's credit rating for Senegal is at B+, while Moody's rating for Senegal sovereign debt is B1.

stages with a lower impact in between[11]. Senegal already has a good legal framework for encouraging investment, but needs to pay greater attention to the consistency of the investments with its broader PSE objectives and policies in mind (e.g. the upgrading of export quality, skills/technology transfer).

- ***Promote export-friendly institutions.*** Institutions are crucial, but experience elsewhere seems to suggest that institutions matter more at higher levels of export performance. Improved institutions will help Senegal overcome some of the main constraints to doing business, such as credit access to would-be investors, cumbersome procedures, enforcement of contracts, property rights, and constraints in obtaining long-term credit from commercial banks. Better institutions should foster more efficient administration, which is important for the country's competitiveness. Senegal needs to persevere in its efforts to work with development partners in these areas.

- ***Develop infrastructure.*** Export performance depends critically on physical infrastructure (roads, ports, energy and telecommunications). Senegal's PSE accords draw significant attention to infrastructure investments, with ambitious programs to modernize the Port of Dakar, build a new international airport, which is expected to handle two times as much the capacity as the current one, and improve the road network.

- ***Boost human capital development and productivity.*** Public investment should also be devoted to increasing the availability and quality of human capital and appropriate use of technology.

[11] Studies show a U-shaped distribution, which is strong at the outset, then weakens as export development advances, only to become stronger again at later stages of export development (see reference).

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GROWTH, STRUCTURAL TRANSFORMATION, AND EXPORT DIVERSIFICATION[1]

The Plan Sénégal Emergent (PSE) envisages boosting economic growth through a large scale-up of investment and structural transformation. This note examines these goals against the background of Senegal's historical growth performance with respect to three main areas: (i) total factor productivity, (ii) export diversification and quality, and (iii) perceived constraints in the informal sector. It finds that, in order to yield growth gains, additional capital increases need to be accompanied by increases in total factor productivity, investment in human capital, and broader financial inclusion. Diversification would benefit growth and stability mainly through increases in the shares of the existing product base, which are complemented by increases in product quality.

1. **Growth in Senegal has been modest with relatively high volatility compared to benchmark cases** (Figure 1). Real GDP amounted to less than 4 percent per year on average over the last 20 years, far below a group of fast growing Sub-Saharan countries that succeeded in almost quadrupling real GDP over the same time horizon. Real GDP per capita has grown slowly, outperformed by several multiples by regional and non-regional benchmarks. The volatility of growth, however, was in line with the average of the Sub-Saharan experience, and mainly driven by large fluctuations in agricultural production, not sufficiently smoothed by other sectors.

2. **This section examines Senegal's growth performance against the background of three areas of relevance for the PSE:**

- *Growth decomposition*. Total factor productivity (TFP) and human capital are highlighted as constraints from the production side, with manufacturing, wholesale and agriculture experiencing particular problems in this area. Capital's relative size and contribution to growth is shown to be high compared to other countries, so that increases in investment volumes should be accompanied by efficiency increases to yield growth dividends.

- *Export diversification and quality*. Senegal has made strong progress in the diversification of its export product and partner base over the last decades, but additional diversification could yield significant growth and stability gains, especially when complemented by improvements in export quality, which is still lagging far behind benchmark countries. Increasing the shares of production of product of comparatively high quality could boost growth but will require investments in human capital and institutions.

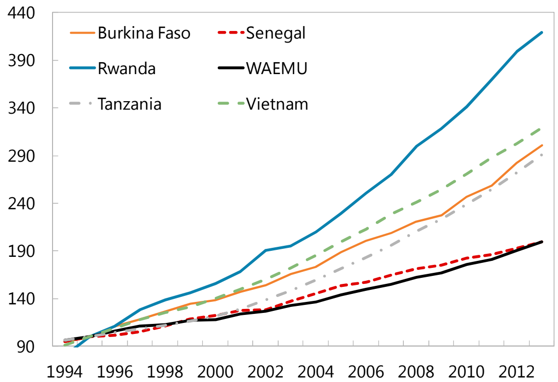
- *Informality*. In addition to the constraints described above, a recent informal business survey points to limited access to finance and educational attainment as major structural problems in the informal sector.

[1] Prepared by Monique Newiak.

Figure 1. Senegal: Growth and Volatility

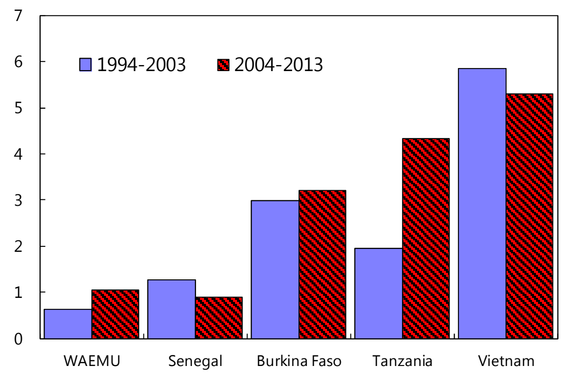
Growth has been outperformed by several benchmarks…

Real GDP, 1994-2013
(Index, 1995=100)



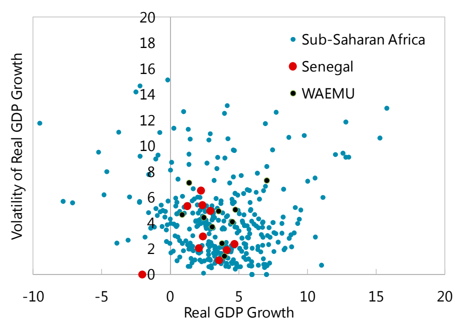
…and per capita income has grown only modestly.

Real GDP Per Capita Growth, 1994-2013
(In Percent)



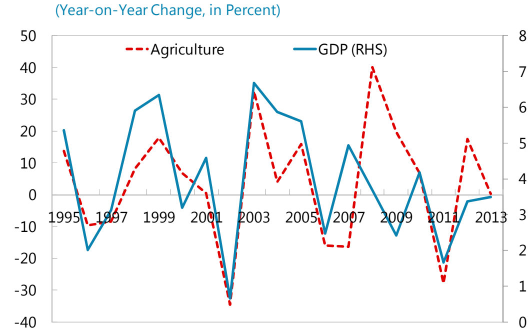
Growth has been volatile, …

Growth and Volatility in SSA since 1960
(Growth: Five-Year Averages, Volatility: Five-Year Standard Deviation)



…mainly driven by large swings in the agricultural sector.

Real GDP Growth, 1995-2013
(Year-on-Year Change, in Percent)



Source: IMF World Economic Outlook April 2014 and staff estimates.

A. Factor Inputs

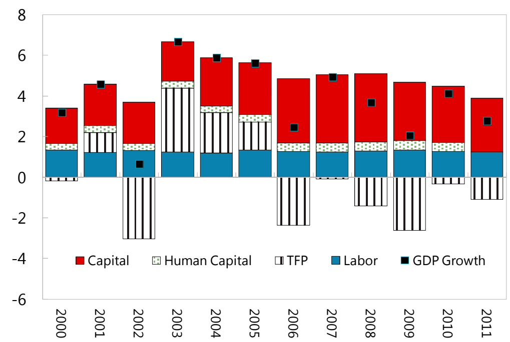
3. Low factor productivity has moderated growth in several sectors (Figure 2). A growth decomposition exercise shows that growth was mainly driven by capital growth, while human capital development and TFP growth had a modest or even negative effect, respectively. A sectoral composition of TFP reveals that its unfavorable contribution has been driven mainly by wholesale and retail trade, manufacturing and agriculture; while mining, construction and service contributed positively to TFP growth. Similar conclusions can be drawn from a decomposition of labor productivity which benefited only modestly from increases in human capital and TFP increases over the last decade on average.

4. With productivity being the main constraint, policies targeting higher growth levels should therefore focus on increasing efficiency and developing human capital. The results indicate that additional increases in investment volumes may not result in desired growth gains if they are not accompanied by gains in productivity. With low public investment management scores, improving the quality and of investment and efficiency of the public investment management system, for example through enhancing project evaluation through ex ante cost benefit analysis and an alignment of the project evaluation cycle with the annual budget process, will be important (Figure 2, chart 5). With 93 percent of public primary and secondary educational spending representing personnel costs (of which 28 percent are paid to non-teaching staff), improvements to the human resource management, including better systems and controls at the central level, will be necessary to leave more room for classroom supplies, textbooks and teacher training. Finally, improvements to the business environment could yield substantive gains, with the electricity sector currently constituting the main constraint.

Figure 2. Productivity

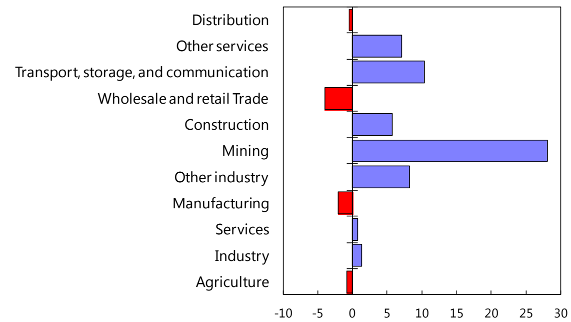
The contributions of labor and capital to growth have been stable, but TFP growth has been weak, …

Real GDP Growth
(In Percent)



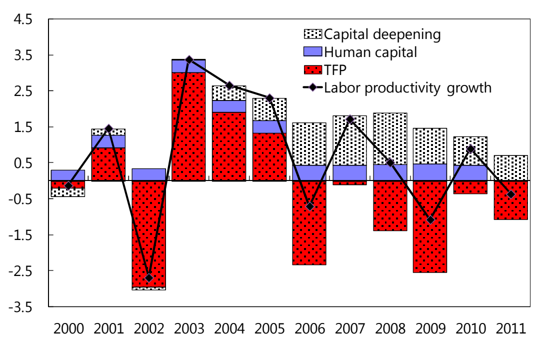
…due to negative TFP growth in several sectors…

TFP Growth by Sector, 2000 - Latest Available
(In Percent)



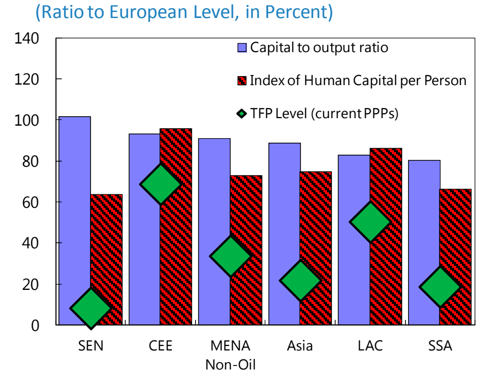
…which has also dampened labor productivity growth.

Labor Productivity Growth
(In Percent)



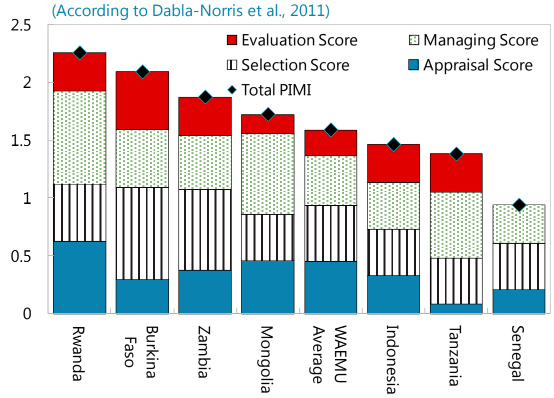
The capital-to-output ratio is similar to SSA and other regions' averages, but human capital and TFP is low.

Input Factor Indicators
(Ratio to European Level, in Percent)



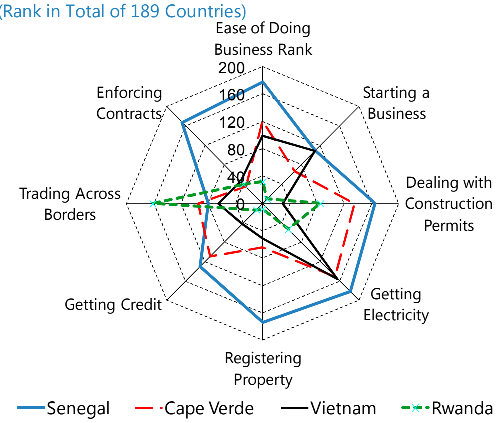
Boosting growth will require improving the quality of public investment…

Public Investment Efficiency (PIMI Score)
(According to Dabla-Norris et al., 2011)



…and substantial improvements in the business climate.

Doing Business, 2014
(Rank in Total of 189 Countries)



Sources: Chart 1-4: Dabla-Norris et al. (2013), Chart 5: Dabla-Norris (2011), Chart 6: World Bank (2013).

B. Export Diversification

5. Senegal's exports have been increasingly diversified, with convergence to benchmark countries (Figure 3). Standing out from the average WAEMU country, overall export diversification along export products (see Box 1) has been increasing over the last decades, mainly as a result of an increase in the intensive margin of product diversification. While diversification is still lower than that observed in some African and non-African benchmark countries, such as Vietnam and Tanzania, and main export categories are still dominant, some convergence to benchmark levels has been ongoing over the last two decades. The same trend has been observed for diversification across export partners, but through a diversification of both the extensive and intensive margin.

Box 1. Senegal: Export Diversification and Quality
(IMF 2014a and Henn et al., 2013)

Export product diversification is captured by the Theil index which can be decomposed into a "between" and a "within" sub-index:

$$Theil\ Index = \frac{1}{N}\sum_{i}^{N}\frac{Export\ Value_i}{Average\ Exp.\ Value}\cdot\ln\frac{Export\ Value_i}{Average\ Exp.\ Value}$$

$$= Theil_{between} + Theil_{within}$$

in which *i* is the product index and *N* the total number of products. The "between" Theil index captures the *extensive margin* of diversification, i.e. the number of products, while the "within" Theil index captures the intensive margin (product shares).

Export partner diversification. The Theil index is also available across export partners. In this case, *i* and *N* in the above relationship represent the export partner index and number of export partners, respectively.

Export quality is measured by the export's unit value adjusted for differences in production costs, relative distance to the trade partner, and the development of a country through the following relationship:

$$Trade\ Price_{mxt} = \alpha_0 + \alpha_1 \ln unobservable\ quality_{mxt} + \alpha_2 \ln p.c.income_{mxt} + \alpha_3 \ln Distance_{mxt} + Error_{mxt},$$

in which the sub-scripts *m, x*, and *t* denote importer, exporter and time period respectively

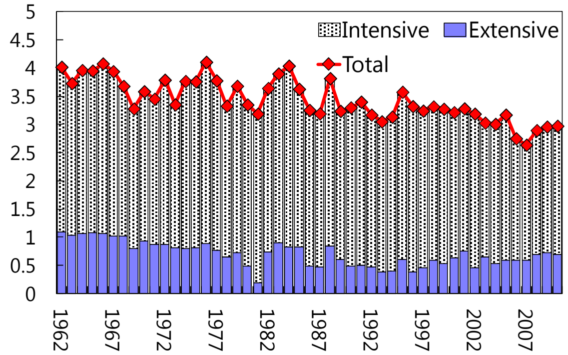
6. Further product diversification could yield growth gains (Figure 3, last chart). While Senegal's economy is already relatively diversified, further increasing product variety similar to diversification success stories could yield further growth gains. Based on the estimates in IMF (2014a), a one standard deviation increase in LIC's export diversification raises the growth rate by about 0.8 percentage points. For Senegal, this translates into estimated growth gains of ¼ percentage point if export diversification was raised to levels observed in, e.g., Tanzania.

7. Further diversification across products and partners could also help restrain the volatility of growth (Table 1 and 2). This note follows the methodology in IMF (2014a) in estimating a two-stage GMM regression to quantify the effect of diversification on the volatility of growth in a dynamic panel, but focuses on Sub-Saharan African countries and extends the regressions by examining the effects of the extensive margin of product diversification and the effect of a diversification in export partners. The results show that decreases in volatility are more likely to be achieved through increasing the intensive margin of product or export partner diversification, and that the gains are economically significant. All other things equal, the estimates imply that increasing product diversification to levels in Vietnam or Tanzania could decrease volatility by about one sixth and a quarter, respectively, with similar magnitudes implied by boosts in export partner diversification.

Figure 3. Senegal: Export Diversification

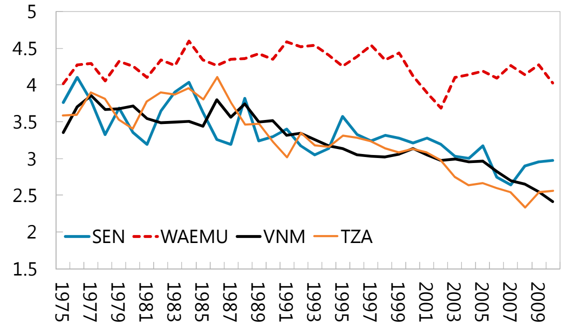
Product diversification has improved, mainly driven by improvements in the intensive margin…

Extensive and Intensive Margin of Product Diversifcation
(Theil Index Decomposition)



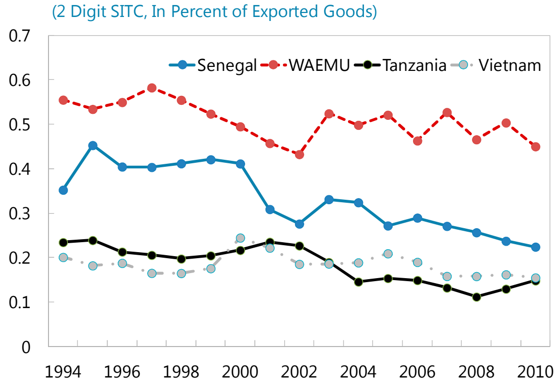
… in line with trends observed in benchmark countries.

Product Diversification Index
(Higher Score = Less Diversification)



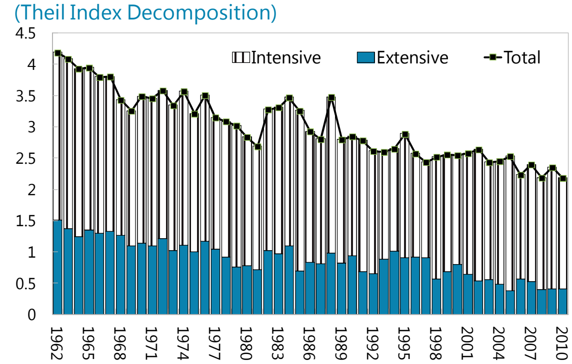
However, main export categories remain relatively dominant.

Share of Top Export Good
(2 Digit SITC, In Percent of Exported Goods)



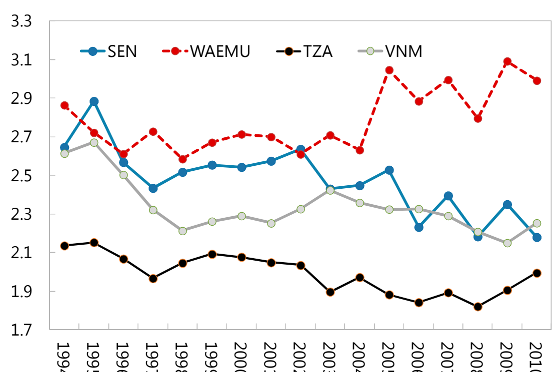
The number of export partners has been increasing, raising export partner diversification…

Extensive and Intensive Margin of Partner Diversification
(Theil Index Decomposition)



…to levels comparable with Vietnam.

Partner Diversification Index
(Higher Score = Less Diversification)



Growth effects from further product diversification could be substantial.

Growth Effects from Increased Diversification in Senegal and the WAEMU
(Increase in Annual Growth Rate, Average 2001-2010)

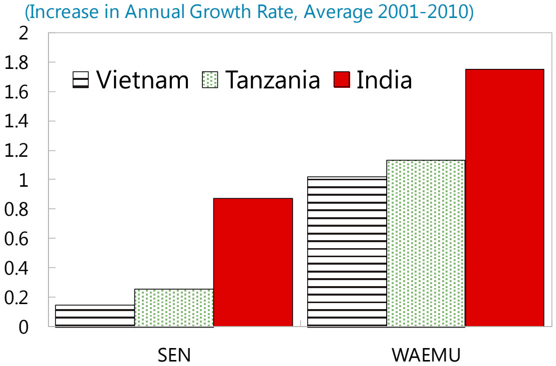


Table 1. Senegal: Output Volatility and Product Diversification in Sub-Saharan Africa
(Higher Theil Index = Less Diversification)

Variables	Export Diversification			Export Diversification and Openness			Export Diversification and Controls			Export Diversification, Controls and Trade Interaction		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Lagged growth volatility	0.174 **	0.174 **	0.310 ***	0.132 *	0.147 **	0.213 ***	0.128 *	0.139 **	0.213 ***	0.054	0.027	0.083
	(0.088)	(0.074)	(0.110)	(0.078)	(0.060)	(0.057)	(0.074)	(0.062)	(0.056)	(0.108)	(0.100)	(0.077)
Export Theil Index	2.145 ***			1.514 **			1.650 ***			-5.99 ***		
	(0.647)			(0.636)			(0.558)			(2.254)		
Within Export Theil Index		2.211 ***			1.501 **			1.559 ***			-4.588 ***	
		(0.638)			(0.595)			(0.562)			(1.234)	
Between Export Theil Index			-0.094			-0.662			-0.097			8.848 **
			(1.329)			(1.518)			(1.939)			(4.165)
Trade Openess				0.035 *	0.032 *	0.039 **	0.033	0.036 **	0.038 **	-0.38 ***	-0.193 ***	0.121 ***
				(0.020)	(0.175)	(0.0157)	(0.020)	(0.017)	(0.018)	(0.136)	(0.033)	(0.041)
Interaction Export Theil Index and Openess										0.086 ***		
										(0.029)		
Interaction Within Export Theil Index and Openess											0.060 ***	
											(0.009)	
Interaction Between Export Theil Index and Openess												-0.086 **
												(0.039)
Terms of Trade Volatility							0.004	0.006	0.009	0.018	0.011	0.003
							(0.005)	(0.008)	(0.010)	(0.015)	(0.01)	(0.006)
Exchange Rate Volatility							0.009	0.010 **	0.006	0.001	0.000	-0.001
							(0.007)	(0.005)	(0.008)	(0.005)	(0.004)	(0.007)
Inflation Volatility							-0.010	-0.011	-0.005	-0.003	-0.002	0.001
							(0.008)	(0.007)	(0.012)	(0.005)	(0.005)	(0.008)
Constant	-7.074 **	-2.763	0.923 **	-4.551 *	-2.59	2.362	-7.488 ***	-6.81 ***	-2.166 **	27.05 ***	19.48 ***	-9.427 ***
	(2.803)	(2.358)	(0.377)	(2.602)	(2.519)	(2.321)	(2.208)	(2.580)	(1.087)	(9.963)	(4.330)	(3.371)
Observations	344	344	344	344	344	344	308	308	308	308	308	308
Hansen test p-value	0.741	0.706	0.602	0.791	0.620	0.603	0.850	0.891	0.785	0.937	0.757	0.862
Arellano-Bond AR(1)	0.009	0.008	0.010	0.009	0.005	0.005	0.010	0.01	0.007	0.018	0.021	0.020
Arellano-Bond AR(2)	0.905	0.801	0.550	0.855	0.728	0.557	0.891	0.891	0.562	0.852	0.810	0.778

Notes: Robust standard errors in parentheses. Period dummies were included, but are not reported. *** p<0.01, ** p<0.05, *p<0.1.

Table 2. Senegal: Output Volatility and Trade Partner Diversification in Sub-Saharan Africa

(Higher Theil Index = Less Diversification)

	Export Diversification			Export Diversification and Openness			Export Diversification and Controls			Export Diversification, Controls and Trade Interaction		
Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Lagged growth volatility	0.120 **	0.153 **	0.171 ***	0.118 *	0.147 *	0.165 **	0.090	0.111	0.133 **	0.078	0.111 *	0.129 *
	(0.061)	(0.077)	(0.064)	(0.063)	(0.079)	(0.068)	(0.071)	(0.078)	(0.063)	(0.056)	(0.066)	(0.069)
Export Theil Index	2.273 ***			2.122 ***			1.832 *			5.316 **		
	(0.638)			(0.672)			(0.941)			(2.293)		
Within Export Theil Index		1.699 **			1.526 **			1.734 **			2.671	
		(0.750)			(0.735)			(0.743)			(1.761)	
Between Export Theil Index			-0.657			-0.546			-0.693			-0.365
			(0.748)			(0.723)			(0.616)			(1.518)
Trade Openess				0.006	0.0038	0.009 **	0.005	0.000	0.007	0.153 *	0.053	0.009
				(0.007)	(0.006)	(0.007)	(0.007)	(0.006)	(0.007)	(0.087)	(0.044)	(0.017)
Interaction Export Theil Index and Openess										-0.052 *		
										(0.029)		
Interaction Within Export Theil Index and Openess											-0.022	
											(0.018)	
Interaction Between Export Theil Index and Openess												-0.003
												(0.024)
Terms of Trade Volatility							0.003	0.001	0.007	0.005	0.004	0.006
							(0.005)	(0.005)	(0.006)	(0.005)	(0.005)	(0.005)
Exchange Rate Volatility							0.003	0.004	0.000	0.005	0.005	0.000
							(0.003)	(0.003)	(0.003)	(0.004)	(0.004)	(0.003)
Inflation Volatility							-0.001	0.000	0.006	0.000	0.000	0.007
							(0.006)	(0.005)	(0.006)	(0.007)	(0.005)	(0.007)
Constant	-4.340 **	-2.376	5.044 ***	-3.398	-2.284	0.888	-2.795	0.256	4.562 ***	-12.916 *	-1.745	0.145
	(1.586)	(1.165)	(1.496)	(2.688)	(1.646)	(0.591)	(3.541)	(1.893)	(1.555)	(7.405)	(4.038)	(1.1881)
Observations	335	335	335	335	335	335	299	299	299	299	299	299
Hansen test p-value	0.645	0.706	0.679	0.633	0.713	0.677	0.735	0.832	0.868	0.829	0.866	0.874
Arellano-Bond AR(1)	0.010	0.008	0.008	0.010	0.010	0.008	0.016	0.015	0.010	0.012	0.013	0.009
Arellano-Bond AR(2)	0.459	0.344	0.303	0.466	0.369	0.329	0.451	0.347	0.254	0.507	0.329	0.258

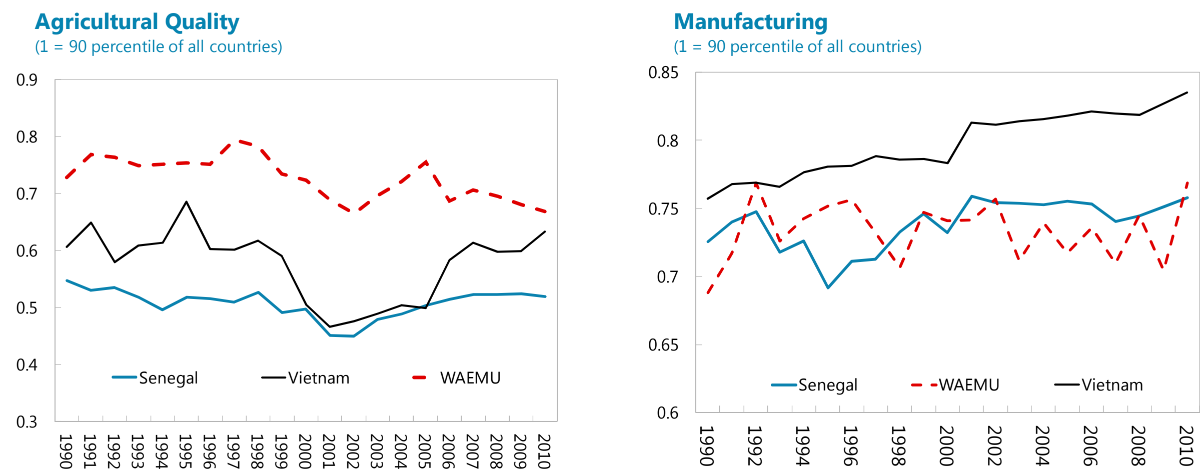
Notes: Robust standard errors in parentheses. Period dummies were included, but are not reported. *** p<0.01, ** p<0.05, *p<0.1.

C. Product Quality

8. There is a large scope for both agricultural and manufacturing upgrading. Export quality (see box 1) has not caught up to benchmark countries. Agricultural export quality has been outperformed even by the WAEMU, the immediate regional reference group, and manufacturing quality has been hovering far below fast quality upgrading countries, such as Vietnam. As an increase in the agricultural and manufacturing quality indices by 0.1 is associated with additional annual GDP per capita growth rates of ½ and 1 percentage points (IMF, 2014a), respectively, the growth losses from this limited convergence could be large.

Figure 4. Senegal: Agricultural and Manufacturing Quality

Convergence in export quality has been slow in both agricultural and manufacturing sectors.

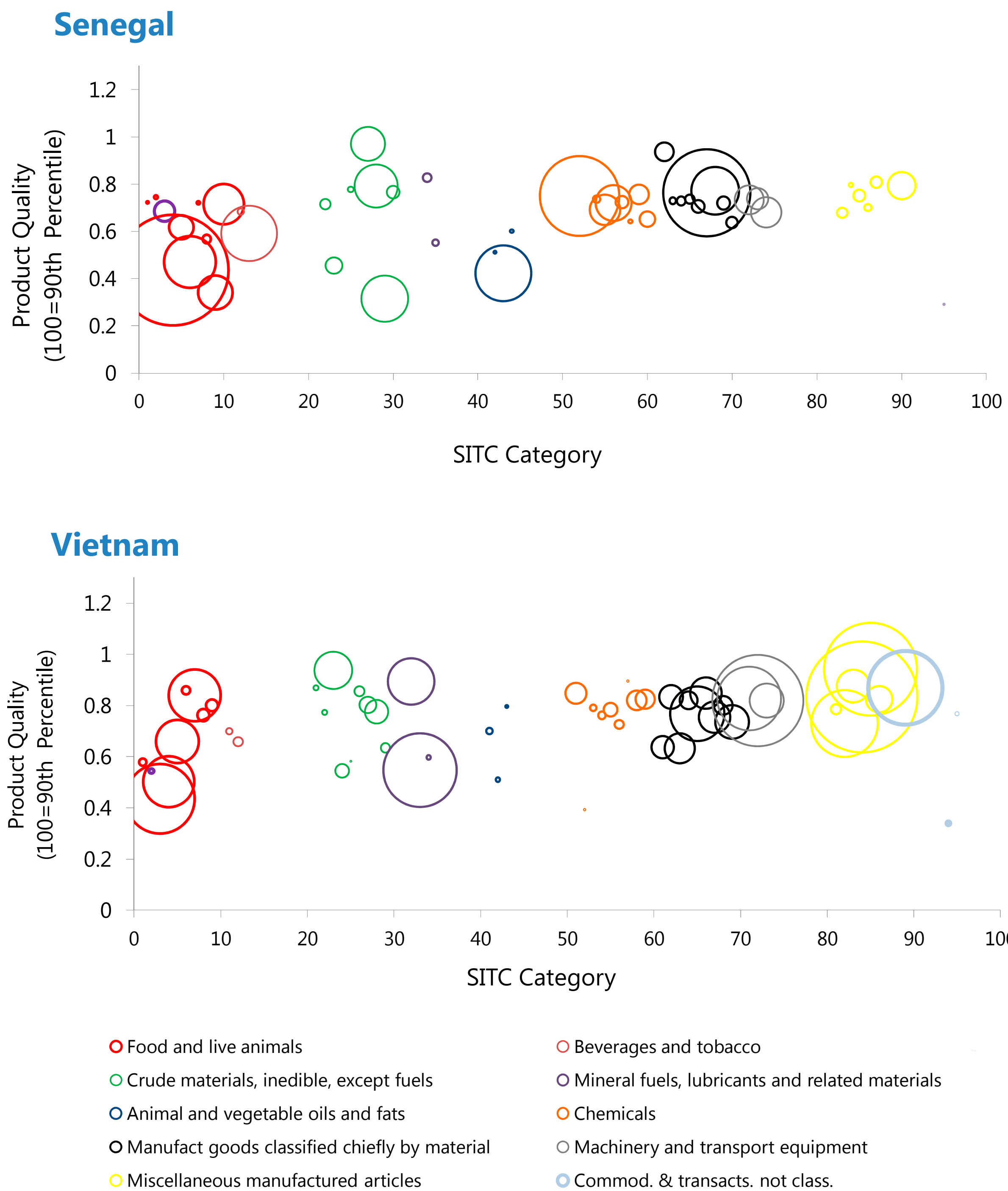


Source: IMF (2014a), Henn et al. (2013).

9. Export concentration appears to be highest in low-quality sectors, while higher quality exports bear a comparatively lower weight. Figure 5 illustrates the dilemma in quality upgrading compared to three benchmark countries with 2 digit SITC level disaggregated industries. In Senegal, sectors for which the quality of exported products is comparatively low, such as food and live animals, constitute a large share of exported products. In comparison, the largest export shares are devoted to product categories with relatively higher quality in Vietnam. With Senegal's labor force concentrated in agriculture, policies fostering agricultural quality may be the first priority.

Figure 5. Senegal: Export Concentration and Quality
(Size of Bubbles Proportional to Product Share)

A large part of Senegal's export products is of comparatively lower quality, while the export share of higher-quality, e.g. manufactured, goods remains comparatively low.



Source: IMF (2014a), Henn et al. (2013).

D. Informality

10. An informal business survey confirms a gap in human capital and highlights financing as another constraint to growth. Figure 5 highlights the main results of a survey covering Senegal's non-agricultural informal sector enterprises. This sector employs about 2.2 million people and contributes about two fifths to Senegal's total GDP (ANSD, 2013). It therefore represents Senegal's economy well. In line with the constraints to education highlighted above, the results of the survey show that the majority of actors in the informal market do not possess education exceeding the primary level. The constraint to the business environment perceived among the severest is access to finance, with the majority of participants relying on their personal saving as their main source of financing.

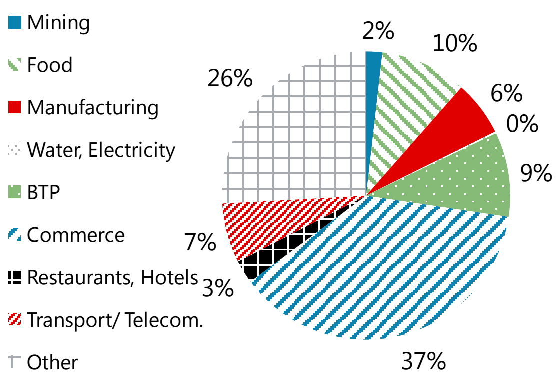
E. Conclusions

11. Policies should target increases in TFP productivity, and further export diversification should be complemented with improvements in product quality. With TFP and human capital being the main constraints from the production side, and the relative level of capital already high compared to other countries, any investment scale-up should be accompanied by efficiency increases and investments in human capital to yield growth dividends. Sectors that could benefit the most from increased productivity are manufacturing, wholesale and agriculture. Senegal has made strong progress in the diversification of its export product and partner base over the last decades, but export quality is lagging behind benchmark countries. Increasing the shares of production of product of comparatively high quality could boost growth but will require investments in human capital and institutions as well. Increasing access to finance and educational attainment could be priority structural reforms from the informal sector's perspective.

Figure 6. Senegal The Informal Non-Agricultural Sector

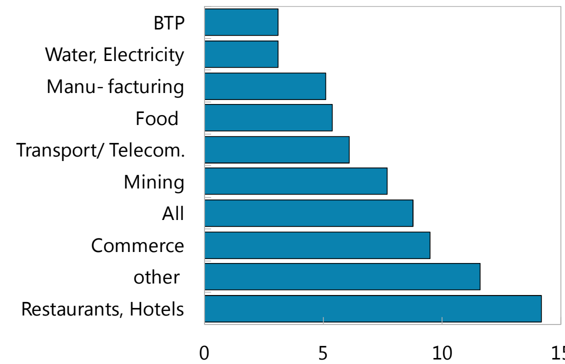
Commerce and food processing constitute the main sectors of the non-agricultural informal sector.

Contribution to Value Added
(In Percent of Informal Non-Agricultural Value Added)



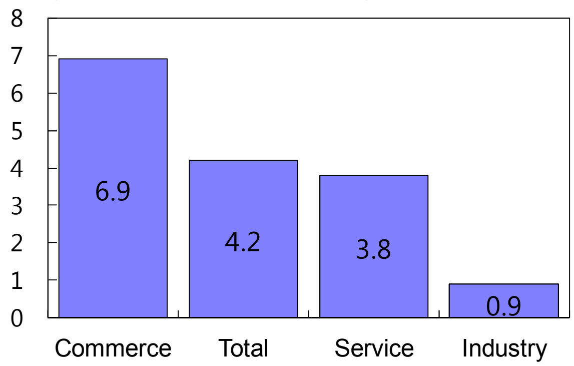
Only few firms are officially registered...

Registration to NINEA
(In Percent of Survey Respondents)



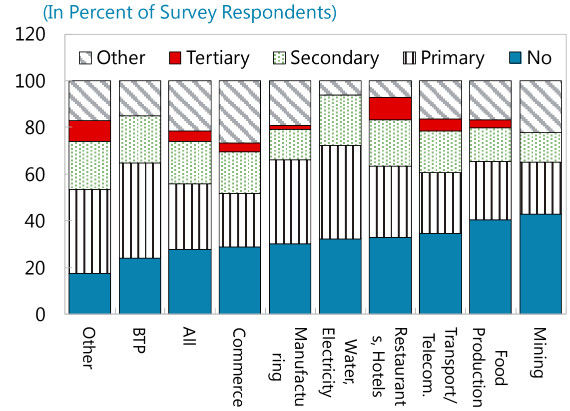
...so that the tax ratio is modest.

Taxes Paid
(In Percent of Value Added)



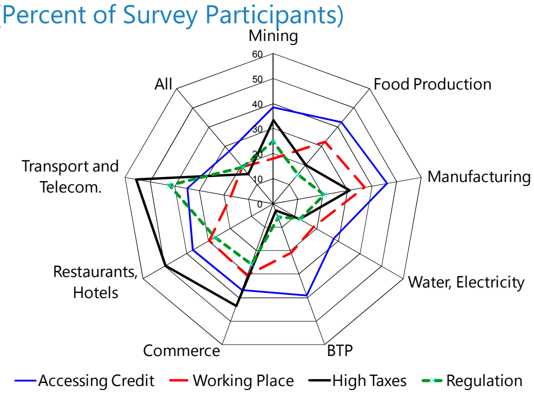
The educational attainment is low.

Highest Educational Attainment
(In Percent of Survey Respondents)



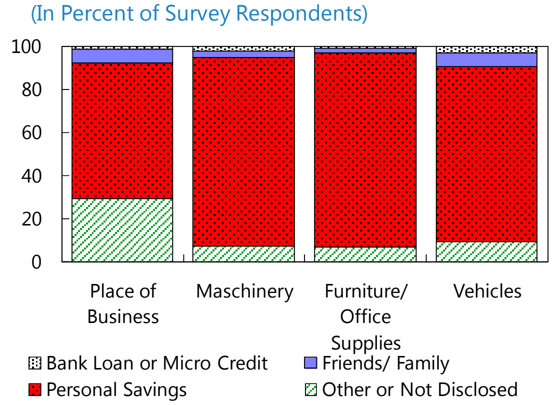
The access to credit is perceived as the major constraint...

Structural Difficulties
(Percent of Survey Participants)



... with most equipment financed through personal savings.

Main Source of Financing
(In Percent of Survey Respondents)



Source: ANSD (2013).

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SOLVING THE ELECTRICITY PUZZLE[1]

The fiscal cost of the electricity sector continues to weigh heavily on the government's budget. As a result, there is an opportunity cost for development spending, while the economy still faces significant bottlenecks with high electricity costs and insufficient electricity production. Cross-country experiences provide useful guidelines on successful reforms, particularly on the fiscal front. Senegal also has an opportunity to lower tariffs, eliminate fiscal subsidies and expand coverage, provided it accelerates the introduction of new low cost generation. Moreover, this can be done at low cost to the government budget through the use of power purchase agreements that could be reached through transparent tenders.

A. The Electricity Sector Represents both Challenges and Opportunities for the PSE

1. **Limited access to affordable electricity is a significant impediment to private sector development**. Electricity is generated primarily by oil-fired plants. As a result of this limited access to electricity, Senegal suffers from one of the highest production costs in Sub-Saharan Africa (SSA): about US$ 30 cents per kWh. To situate how bad this is, power tariffs in most parts of the developing world fall in the range of US$0.04 to US$0.08 per kilowatt-hour. Even relative to Sub-Saharan Africa Senegal scores badly; its tariff is over twice the average tariff of US$0.13 per kilowatt-hour.[2] In parallel, its electricity prices that are among the highest in SSA, set at about 30-40 percent below cost recovery. Overall, access to electricity remains low because of high costs and insufficient generation. Senegal receives its lowest score in the World Bank Doing Business indicators for the access to electricity: 182nd country out 189.[3]

2. **In addition, Senegal allocates a significant portion of its budget to support the electricity sector, which represents a major opportunity cost in terms of forgone development spending**. In order to limit the pass-through of production costs to retail prices, the government subsidizes the electricity sector. It results in an explicit tariff compensation of about 1–1½ percent of GDP in recent years. These direct transfers also complicate budget management, as they are usually higher at the end of the year than initially budgeted (Figure 4). In addition to the explicit fiscal transfer to compensate for tariffs, the electricity company, Senelec, has also accumulated tax arrears (0.7 percent in 2013) and benefited from government financing for some of its investments (0.3 percent in 2013). Thus, the total fiscal cost of the electricity sector is significantly higher than just the direct transfer, and amounted to 2.5 percent of GDP in 2012 and 2.0 percent in 2013. Additionally, empirical evidence on Senegal and elsewhere from the mid-2000s suggests that tariff subsidies do

[1] Prepared by Olivier Basdevant.

[2] According to the World Bank Fact Sheet: The World Bank and Energy in Africa at http://web.worldbank.org.

[3] http://www.doingbusiness.org/data/exploreeconomies/senegal.

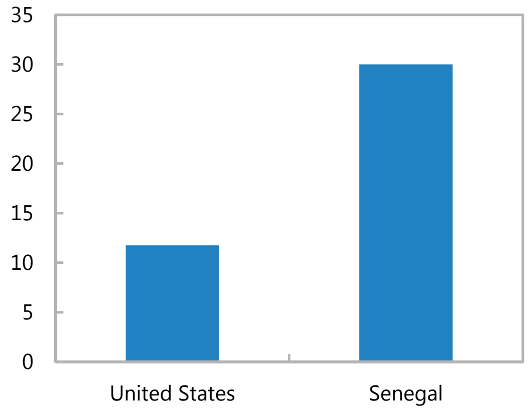
not benefit primarily the poor, since most of them are not connected to the power grid as a result of either unavailability or cost (World Bank, 2008, Arze del Granado and others, 2010). Even if subsidies were benefiting the poor in absolute terms, their distributional effects have been regressive since electricity consumption is itself unevenly distributed across regional areas and income groups. Finally, subsidies to the electricity sector divert important resources needed to finance pro-poor and priority spending. For example, annual transfers to Senelec were comparable to or higher than the resources allocated for capital spending in the health or education sector (Figure 1).

3. However, the electricity sector represents an opportunity for Senegal, as investment in more efficient plants will eventually solve these issues. The authorities have adopted an investment plan to reduce production costs and increase capacity, but recurrent delays and changes to the plan hamper its effectiveness. The plan relies on more efficient power plants (Sendou, Tobène, Africa Energy) and imports from Mauritania. Eventually, electricity production would combine coal, natural gas, hydropower and renewable energy. This program would not only increase production, but also substantially reduce unit production costs. While the plan is in line with successful reforms in SSA, it has been revised frequently, and its implementation has incurred recurrent delays. As a result of these delays, three issues mentioned above (electricity cost, lack of generation, and high budgetary costs) continue to weigh negatively on Senegal growth potential. Against this background, successful experiences in implementing energy sector reforms in some SSA countries could help Senegal in ensuring that reforms could move forward, and subsequently make the PSE growth objectives a reality.

Figure 1. Senegal: The Fiscal Costs of the Electricity Sector

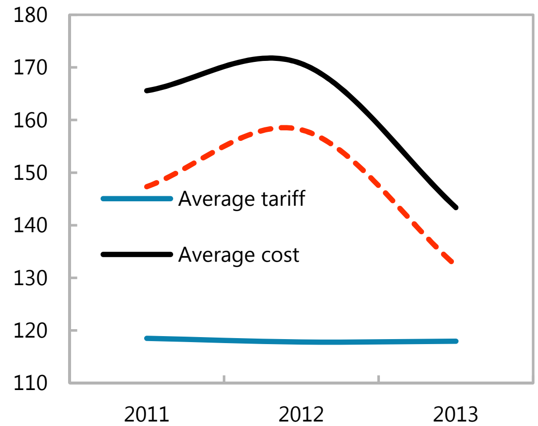
Electricity production costs are much higher than in advanced and emerging economies.

Electricty Production Cost
(US$ cents per KWh)



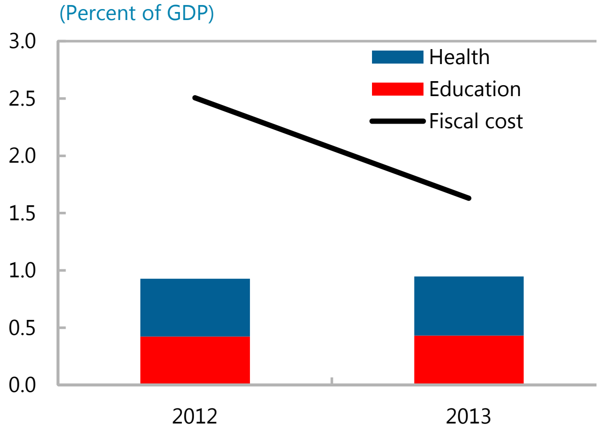
Additionally, tariffs are set well below cost recovery, in part because tariffs are already high.

Tarrif Gap, 2011–19
(CFAF per KWh)



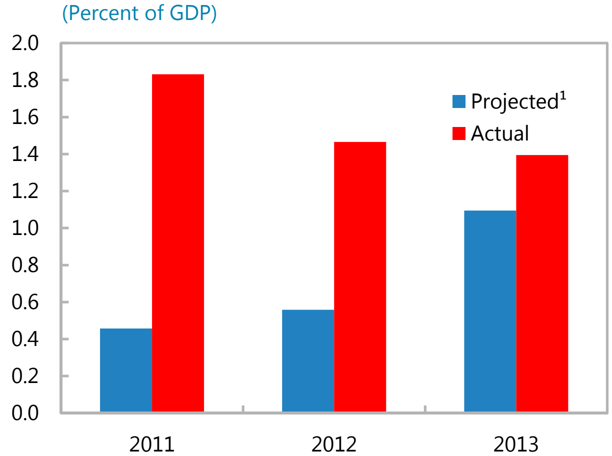
As a result, the the budget finance the electricity sector, which leaves less resources for poverty-reducing expenditures.

Transfers to Senelec and Investment Spending on Social Sectors, 2012–13
(Percent of GDP)



Moreover, the ex-post transfers to the electricity company Senelec tend to be higher than ex-ante.

Tariff Compensation, 2011–13
(Percent of GDP)



Sources: Countries authorities, World Bank, and IMF staff estimates and projections.

B. Successful Electricity Reforms

4. Successful electricity reforms in Sub-Saharan African countries can help understand how Senegal could address its own challenges (IMF, 2013). Low access, high costs and unreliable supply plague much of the continent, so although Senegal is amongst the outliers, it is not the only African country to face this challenge and can build on the experience of other countries' past reforms. Successful reforms incorporate price adjustment, investment in cost reduction, proper outreach to users, and a strategy that includes social safety nets.

5. Investing to reduce cost and increase generation is the right strategy. Senegal's strategy fundamentally is the right one. All successful cases of energy reforms have indeed implemented investment to improve the energy mix, thus reducing electricity costs, improving generation capacity and phasing out budgetary costs. What is peculiar in Senegal's situation are the recurrent delays in implementing the investment plan. An avenue that could be explored is finding ways to strengthen credibility in the plan, by demonstrating commitment to implement it. To do so three avenues could be explored, which have been used by other SSA countries: (i) establishing a public debate with the view of creating a large political and social consensus on all aspects of the reforms (i.e. not just the investment plan), (ii) considering tariff adjustments to mitigate the budgetary impact of potential delays and preserve room for development spending in the budget, and (iii) developing social safety nets that can be more efficient in reaching the poor. These three points are discussed further in the following paragraphs.

6. Strengthening support for reform. Electricity subsidies are a highly visible way for governments to benefit their people, even if, overall, they benefit the rich the most. Strengthening support for subsidies reforms would typically involve communicating on their redistributive implications and convincing the population that overall reforms would benefit the majority by better targeting the poor and by unleashing the country's growth potential. In this respect Senegal could consider using elements of communication strategies used in Ghana and Kenya, two countries that achieved successful reforms.

- Ghana's 2005 reform included an active campaign, using media and consultations with the civil society to communicate about the benefits of the reform and to involve all stakeholders (IMF, 2013).

- Kenya consulted with stakeholders early in their reform process, allaying concerns of staff working in their utilities, culminating in their 2004 energy policy which increased tariffs to match long-run marginal costs. Costs increased concurrently with improvements in quality of service, placating consumers (IMF, 2013).

Senegal's authorities could communicate the potential gains from a reallocation of government spending away from electricity subsidies. A convincing argument could be made about the opportunity cost of subsidizing electricity in terms of forgone development spending and/or tax cuts targeted to crowd in private investment, particularly FDI. Furthermore, consumers may become aware that reforms which improve the financial position of Senelec would also lead to better electricity service and access. In order to be effective, the support for the reform could rely on two specific initiatives related to fiscal transparency. First, the fiscal cost of the electricity sector could be presented in its entirety in budget documents, i.e., covering not only the direct transfer but also tax arrears and investment financed by the government. For example, a welcome development is the inclusion of some estimates in the 2015 budget. Second, the fiscal cost would not be considered "given" but would be set as a complement to Senelec's own efforts to reduce its operating costs. In this context, Senelec's performance contract is likely to adequately complement the efforts of fiscal transparency, by providing more information on Senelec own efforts.

7. **Developing social safety nets to protect the poor**. Successful reforms have included programs targeting the poor through two actions: maintaining cheaper electricity for them and improving their access to electricity (notably by the electrification of rural areas). For example, Kenya maintained lifeline (below cost) tariffs to households consuming less than 50 kWh per month which was cross-subsidized by higher rates on larger consumers. In addition, access was improved for the poor, using subsidies financed by donors to invest in infrastructure. Gabon adopted a similar approach, allowing households with extremely low electricity bills to have access to free electricity up to a certain amount. Senegal has made efforts to move in this direction. Specific investments are planned in electricity distribution through the strengthening and modernization of networks, stations and power lines. To achieve the target of 60 percent of rural electrification by 2016, a priority rural electrification three-year program (2014–16) has been developed. In parallel, efforts have been made to revamp social safety nets, with the view of better targeting the poor. The authorities have worked closely with development partners, notably the World Bank, on this issue. However these efforts will take time to bear their fruits, notably in terms of electrification of rural areas.

8. **In parallel to cost-reducing investments, price adjustments are usually necessary**. This is particularly relevant when the utility company needs the tariffs to cover not only its operating costs, but also the cost of its investment. Kenya has undergone reforms which began in the 1990s and continued into the 2000s. At present, this utility company has some flexibility to invest (Ajodhia, Mulder, and Slot, 2012). The price adjustment mechanism includes a pass-through of fuel price and exchange rate fluctuations. Senegal already has high electricity tariffs compared to the region. As such the scope for an across-the-board price adjustment is limited. However, options could be considered to increase tariffs temporarily and selectively, in order to reduce the fiscal burden. However, Senegal may be able to avoid price adjustments if it can rapidly expand low cost generation from coal to replace the existing high cost fuel plants. Moreover, if the majority of the investment is undertaken under power purchase agreements, there would be no need for the State (or Senelec) to borrow to finance the expansion plans beyond the cost of the distribution network. In turn, grants from the EU and other donors for infrastructure targeted to the poor could finance a significant share of this spending without generating financial pressures on the Budget, Senelec or electricity consumers.

C. Conclusion

9. Overall, Senegal's strategy to address electricity sector issues is sound, and in line with international successful experiences. In particular, the investment plan, as well as efforts to improve Senelec financial transparency go in the right direction in terms of reducing costs and improving access to electricity.

10. In order to strengthen the effectiveness of their strategy, the authorities could consider continued efforts in building consensus, especially if difficult decisions, such as price adjustments, were to become necessary. In this respect, an active communication strategy on the gains from a reallocation of government spending away from electricity subsidies would be helpful. This could also positively contribute to the population accepting costs, in exchange for improved accessibility and further down the road reduced costs. Additionally, continued efforts in developing social safety nets would also help mitigate the social costs during the transition.

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SOCIAL SAFETY NETS IN SENEGAL[1]

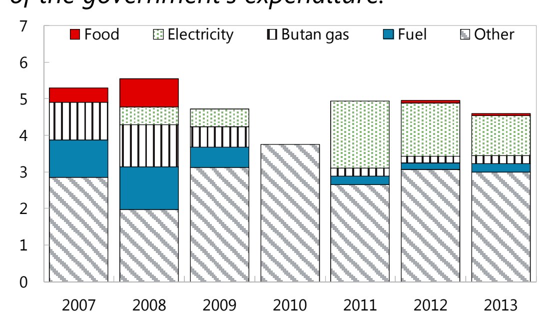
While Senegal has been successful in decreasing poverty rates, the share of the population living below the poverty line and its exposure to shock remains high, emphasizing the need for safety nets. Such nets should be scalable to respond to transient needs while ensuring a minimum social protection for chronic poor and vulnerable populations. Strengthening social protection is high on the authorities' reform agenda, including within the second pillar of the Plan Sénégal Emergent. This section reviews Senegal's current state of social protection and reforms in progress, and outlines main strategies for the design of social security nets going forward.

1. **Senegal has made progress in poverty alleviation, but the poverty incidence remains high, and households are vulnerable to shocks** (Panel 1). In 2001-11 poverty rates declined by 8.5 percentage point, with the largest decreases observed in Dakar, but almost half of the population continues living below the poverty line. The poorest households are particularly vulnerable to idiosyncratic shocks, such as the loss of livestock or harvest, or exogenous shocks, e.g. to the prices of main imports, such as oil, rice and wheat. The majority of households do not have mechanisms to mitigate the impact of such shocks, resulting in households often tapping into savings and selling assets in response to shocks, with the risk of being locked into long-term poverty.

A. Government Response to Shocks and Existing Safety Nets in Senegal

2. **Government's response to exogenous shocks has included financial support to farmers, general assistance to the rural population, and subsidies** (Figure 1). In response to droughts, the government has historically offered food and agricultural inputs, interest rate subsidies and debt forgiveness, while fuel and food price hikes have been countered by a series of fiscal measures, including subsidies on basic foodstuffs and energy such as gasoline, butane and electricity. Most of these measures are poorly targeted: Interest rate subsidies tend to benefit larger rural producers and those able to participate in the formal credit system. Subsidies in response to price hikes may be very expensive and may not reach the intended part of the population. For instance, such subsidies absorbed 2 ½ percent of GDP in 2008, while only 7 or 9 percent of water or electricity subsidies went to the poorest quintile, and urban dwellers accounted for the majority of beneficiaries.

Untargeted subsidies constitute a large share of the government's expenditure.



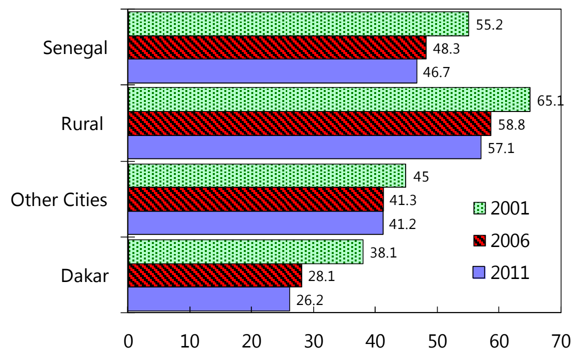
Source: IMF staff and country authorities.

[1] Prepared by Aline Coudouel and Monique Newiak, drawing on World Bank (2014a) and World Bank (2014b).

Figure 2. Senegal: Poverty, Shocks and Consumption

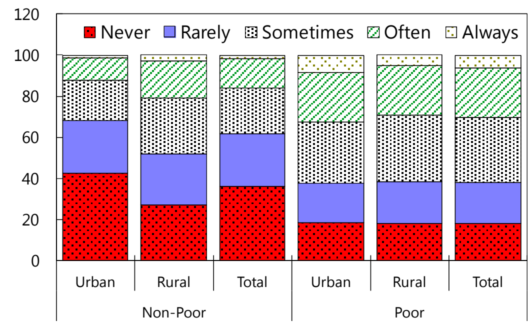
Senegal has made progress in poverty alleviation, but poverty rates remain high, …

Poverty Rates
(Percent of Population Living Below Poverty)



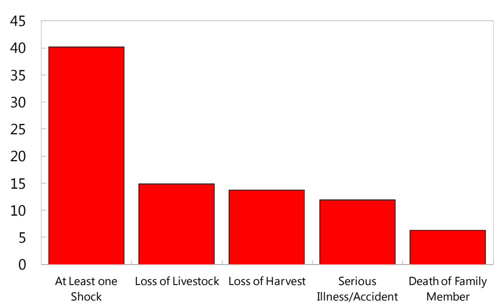
…and problems satisfying basic needs persist.

Frequency of Problems Satisfying Food Needs
(In Percent of Respective Group)



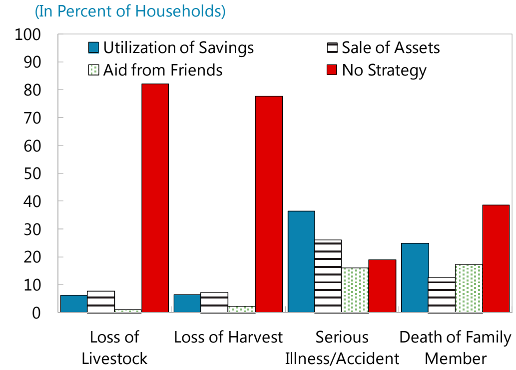
Households remain vulnerable to shocks, …

Exposure to Shocks of Poorest 20 Percent of Households
(In Percent of Self-Reported Shocks Experienced in the Last 12 Months)



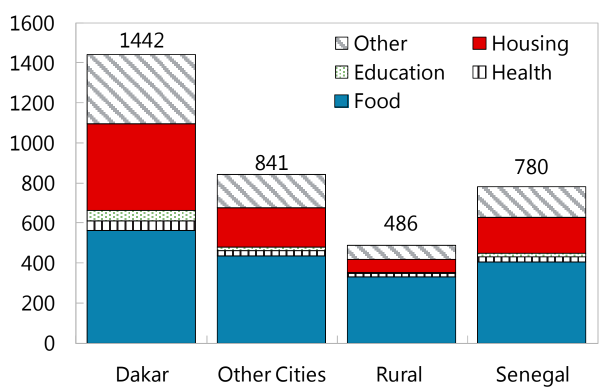
… and have insufficient mechanisms to cope with them.

Strategy to Cope with Shocks
(In Percent of Households)



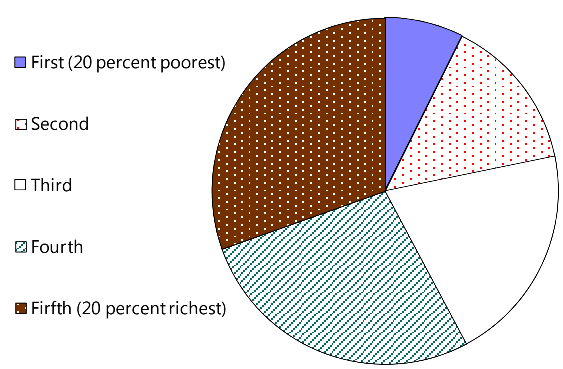
Average daily rural consumption is below 500 FCFA.

Average Daily Expenditure per Person
(in FCFA)



…and the poorest 20 percent of the population account for less than 7 percent of total consumption.

Consumption by Income Percentile
(in Percent of Total Consumption)



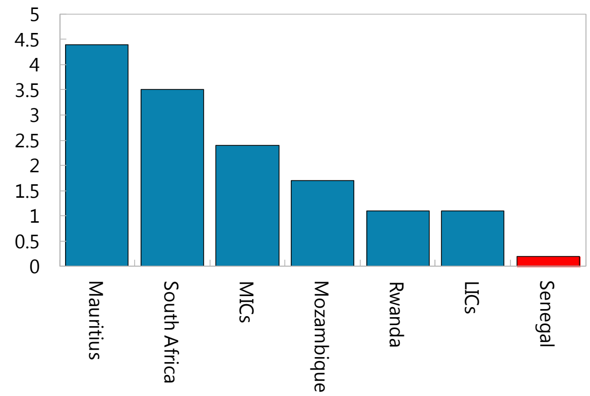
Source: ANSD (2013).

3. **A review of social safety net programs identified a dozen programs in place in Senegal in 2011, often with national coverage.** Box 1 summarizes the dozen social safety nets which were in place in 2011, covering, for instance, school lunches, food assistance, and support to the elderly and disabled, and two pilot cash transfer programs. Expenditures on these programs have averaged about 0.3 percent of GDP over 2008-2011, with school lunch programs accounting for over 70 percent of this spending, reflecting their large coverage. Between 64 and 99 percent of expenditures were dedicated to the cost of the transfers themselves, with the remainder covering administration, monitoring and evaluation. Eight programs had national or quasi-national coverage, but three of the newer programs intervened in more restricted areas: NETs in selected poor rural districts, WFP CV in selected urban areas, IPSEV in rural and semi-urban areas, and the PRP in the rural areas of only three regions.

4. **However, the programs in place in 2011 were not sufficient to protect the poor or in adequately responding to shocks** (Figure 3). In particular, at that time, programs suffered from the following problems:

Figure 3. Senegal: Spending on Social Security Nets in 2011
(in Percent of GDP, excl. subsidies)

Spending on social security nets is low compared to several benchmarks.



Source: Word Bank 2014.

- *Coverage*. Annually, almost one quarter of the population received some type of assistance. However, this number likely overestimated effective coverage of the poor, as recipients of food distribution and school lunches accounted for about 97 percent of beneficiaries, and neither of these two programs screened beneficiaries based on need.

- *Targeting*. Predominantly categorical targeting was often reinforced by geographical prioritization or confirmed through community-based mechanisms. The performance of these targeting systems was mixed: Some programs were effective concentrating on the poorest households (PRN and agricultural support programs), others exhibited significant leakage. For example, the elderly health care program benefited mainly the better off 40 percent of households concentrated in urban households.

- *Impact*. Actual spending per beneficiary showed wide variations between programs. The transfer programs NETS and PAM CV sought a meaningful impact within the tension of an affordable program able to scale-up, while the smallest costs per beneficiary were the school lunch program and the food distribution through the CSA. While coverage of CSA was large, its impact was likely to be limited, at a cost per beneficiary of 353 FCFA per year (Figure 4).

- *Coordination*. Overall, safety net programs tended to be fragmented, lacking coordination, and not adapted to respond rapidly to shocks. Institutional anchorage of the programs was linked mainly to the individual program objectives and its target groups combined with institutional mandates instead of a coordinated strategy of interventions.

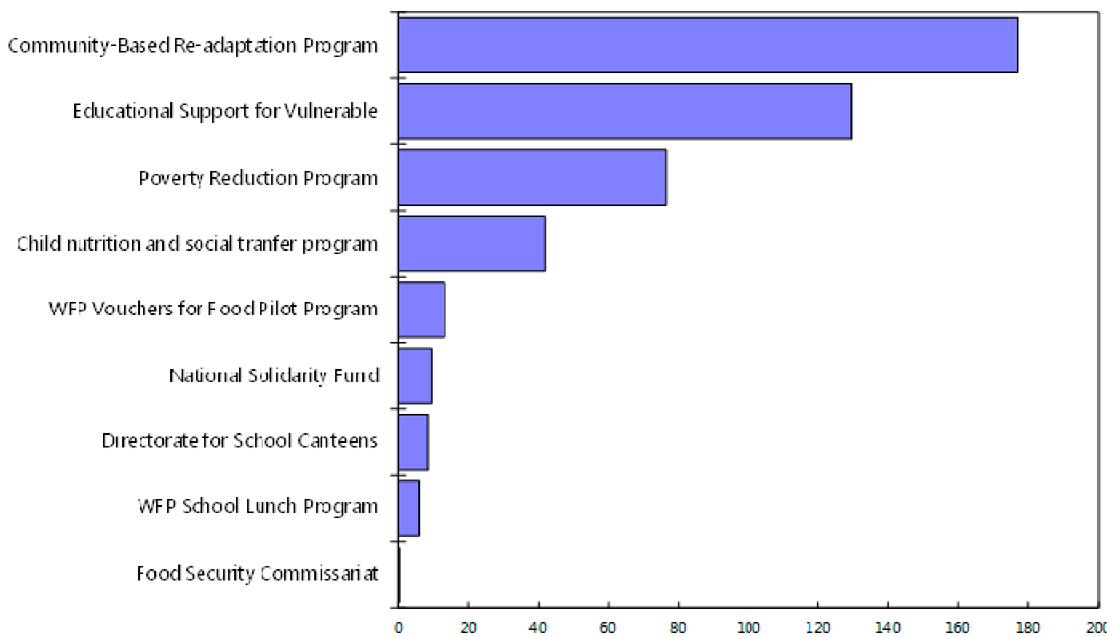
- *Monitoring*. There was no standardized monitoring of program implementation across safety net interventions. With each program establishing its monitoring and evaluation plan and information often collected via program-specific information systems, a national perspective on coverage and impact of safety net programs was missing.

- *Funding*. Safety net funding remained largely dependent on development partner financing.

Figure 4. Senegal: Cost per Beneficiary per Program

(In Thousands of CFAF)

Spending per beneficiary varies widely across programs, with some likely having only minor impact.



Source: Word Bank 2014a.

Box 1. Senegal: Social Safety Programs in Senegal in 2011

In 2011, main benefits are carried out by way of monetary transfers, food aid and fee waivers for health services through programs in the following areas:

Food programs

- Food Security Commissariat *(Commissariat à la Securité Alimentaire, CSA)*: food aid for vulnerable populations in response to catastrophes or through rice distribution at public rallies and religious festivals.
- National School Lunch Program *(Programme d'alimentation scolaire - DCaS)* provides school lunches funded through the national budget.
- WFP School Lunch Program (*PAM Cantines Scolaires)* supports the national school lunch program by providing hot meals in pre- and primary schools located in rural and peri-urban vulnerable areas.
- WFP Vouchers for Food Pilot Program (*Bons d'Achat – PAM CV):* addresses food insecurity among vulnerable households due to rising food prices.

Emergency fund

- National Solidarity Fund (*Fonds de Solidarité Nationale – FSN)*: provides immediate responses to crisis and emergency situations, including financial, medical and material support.

Support targeted at children

- Pilot Cash Transfers for Child Nutrition Program (*Nutrition ciblée sur l'enfant et transferts sociaux-NETS):* cash grants to mothers of vulnerable children under 5 years old to mitigate the negative impacts of food price increases.
- Educational Support for Vulnerable Children (*Bourses d'étude pour les orphelins et autres enfants vulnérables – OEV):* a program through the National HIV-AIDS Council to provide for schooling or professional training to children orphaned or affected by HIV-AIDS and other vulnerable children.
- The Social Protection Initiative for Vulnerable Children (*Initiative de protection sociale des enfants vulnérables* – IPSEV): Cash grants to households to help them maintain vulnerable children and ensure access to health and education services.

Support targeted to other categorical groups

- Community-based Re-adaptation Program *(Programme de réadaptation à base communautaire – PRBC)* provides social, economic and cultural integration for disabled persons via material support and funding of income generation activities.
- Old Age Support Program (*Projet d'appui à la promotion des aînés – PAPA)* aims to address the vulnerable elderly via capacity strengthening, grants and subsidized loans for income generating activities to groups of elderly.
- Sesame Plan (*Plan Sésame*) waives health service fees for all persons over 60 years.
- Poverty Reduction Program (*Programme d'appui à la mise en oeuvre de la Stratégie de Réduction de la Pauvreté – PRP)* supports grants for income generating activities for vulnerable groups, primarily women, the disabled and HIV-AIDS affected populations.

B. Renewed Efforts to Establish an Effective National Social Protection System

5. Over recent years, the Government has taken important steps to set up new institutional arrangements and programs to strengthen Senegal's social protection system:

- *Délégation Générale à la Protection Sociale et à la Solidarité Nationale (DGPSN).* In 2012, the DGPSN was established to help define social protection policy, implement social protection programs, coordinate the National Social Protection Strategy, and participate in monitoring its implementation. To help it play its role of overall leadership and coordination of the social protection sector, an Inter-ministerial Steering Committee on Social Protection was established, which includes both civil society and development partners.

- *Inter-ministerial committee.* The recently established framework includes an inter-ministerial committee responsible for overall decisions on the formulation of implementation of the country's social protection strategy. In addition, a technical steering committee is being established to lead the efforts in terms of social safety nets implementation at a technical level.

- *Programme National de Bourses de Sécurité Familiale (PNBSF).* The Government has launched the PNBSF, a Conditional Cash Transfer program which aims at providing support to the most vulnerable households and promoting investments in human capital on a national scale. The implementation of this program provides the basis for the definition of tools and instruments (for targeting, registry, payment and monitoring and evaluation) that can be used by other social safety nets in the country. Started in October 2013, the program is expected to reach 250,000 households by 2017.

- *Caisse Autonome de Protection Sociale Universelle, CAPSU.* Work in progress also includes the setup of an Autonomous Social Protection Fund which would be responsible for organizing the financing of social protection activities, such as universal health coverage, the national conditional cash transfer program, and pensions for the elderly. The CAPSU, which is still in its conceptual phase, would be responsible for mobilizing resources from a variety of sources, such as individual premiums or contributions, government general resources, private sector resources, special taxes, and contributions from development partners.

C. Recommendations to Further Consolidate the National Social Protection System

The overall goal of the recommendations is to strengthen coordination between currently isolated programs, improve their targeting, increase their coverage, and more generally improve the ability of the national social protection system to effectively protect the most vulnerable and respond to shocks.

6. Build synergies between existing individual programs to progress towards a unified national safety net system. To move to a national safety net system would require building explicit synergies between currently isolated programs. This can be achieved by building links between programs that deliver different safety net functions. For example, households enrolled in cash transfer programs could be automatically eligible for health or education fee waivers or households participating in public works could be linked with income generating projects, microfinance or other asset building programs. Inter-operable management information systems across programs, as well as a central registry of vulnerable households, can provide an important platform to promote connections between programs.

7. Strengthen collaboration between agencies and other key players. Currently programs develop their own local coordination mechanisms, with multiple committees and consultation mechanisms—a common institutional platform would thus create synergies. Collaboration could also expand to other relevant sectors, such as health and education services, and natural disaster management. Harmonization with external partners, including international agencies and NGOs can be improved through central level coordination. The newly formed *Délégation Générale à la Protection Sociale et à la Solidarité Nationale* (DGPSN) and the Inter-Ministerial Committee for the National Social Protection Strategy have an important role to play to continue strengthening such collaboration.

8. Design a medium-term expenditure framework and integrate it into the budget process. Moving from an individual program approach to a national safety system will require developing an overall financial framework for the sector that prioritizes expenditures and builds a sustainable funding basis for safety nets. Such a framework would help translate a national safety strategy into public spending priorities within a multi-year macroeconomic and fiscal framework, which is integrated into the budget process. Central level coordination will help underpin the sustainability of the system. Furthermore, this effort can help rationalize existing programs – redesigning (better targeting, more efficient management, etc.) or eliminating the least effective ones.

9. Develop central monitoring and evaluation mechanisms that informs strategic decision-making and allows program evaluation. A key function of the DGPSN and Inter-Ministerial Committee is to promote the use of rigorous data on various programs to inform the design and implementation of programs and make it possible to demonstrate their impact to political decision-makers, development partners, and civil society, thus enhancing global knowledge of the social safety nets. To this end, it is important that each program develop its own management information system to monitor and evaluate its implementation. It is also critical that these program-specific MIS be inter-operable across programs, so that the coordinating agency can draw from these sources for its sector-wide analysis and facilitate targeting and coordination through a central registry of beneficiaries.

10. Improve targeting to reach the most vulnerable parts of the population. The targeting methodology adopted for the national Conditional Cash Transfer program relies on a combination of community-based targeting and the application of an objective proxy means test that combines information on household characteristics correlated with poverty and vulnerability to confirm their eligibility. In the coming years, it will be important to keep improving on the methodology as new data becomes available, and to ensure that all programs improve on their own targeting of households. The development of a unique registry with ample information on the most vulnerable households is an important step to help each program efficiently apply its own selection criteria without having to replicate the data collection effort.

11. Further strengthen the institutional framework. In the coming years, it is important for the DGPSN to develop its capacity to provide the leadership required for the coordination of the sector and the implementation of the national strategy. In the future, as cross-country evidence suggests that coordination and implementation of specific programs are often separated with maturing systems, the DGPSN could focus its efforts on the overall leadership of the sector and the implementation of the National Social Protection Strategy. It could thus oversee the management of the sector and monitor implementation and results; while the implementation of programs would remain the responsibility of sectoral institutions.

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PERFORMANCE UNDER THE 2011-14 PSI[1]

Senegal has had two successive arrangements under the Fund's Policy Support Instrument (PSI) since 2007. This section focuses on Senegal's performance under the latest PSI with respect to three main areas: the overall macroeconomic performance, program conditionality and other policy targets, and technical assistance. It concludes that the overall macroeconomic performance has been below par but acceptable. The main goals of PSI – higher growth, fiscal and debt sustainability – were broadly achieved, but with less favorable outcomes than initially programmed; program performance has been mixed, with qualitative targets largely met but substantial delays in structural reforms. In addition, Senegal has found the technical assistance from the Fund to be useful, although there is scope for improvement in the implementation of the Fund's recommendations.

1. **The 2011-14 PSI is the latest arrangement in a long history of Fund involvement in Senegal.** At the authorities' request, the three-year PSI, approved by the Executive Board on December 3, 2010, was extended by one year during the Fifth Review, and it is set to expire on December 2, 2014. Under the PSI, Senegal has sought the Fund's advice, monitoring, and endorsement of the authorities' policy framework, without using the Fund's financial assistance.

2. **Senegal's PSI was based on country-owned poverty reduction strategies.** For the initial implementation period, the PSI was aligned with the projections underlying the second Poverty Reduction Strategy (PRSP-II 2006–2010), including an updated macroeconomic framework for 2011-15. In mid-2012, the authorities finalized their National Strategy of Economic and Social Development (NSESD), which outlined policies and reforms for 2013-17 and became the new national strategy supported by the PSI. NSESD devised policies required to push forward the authorities' agenda for high, sustained and inclusive growth, and poverty reduction.

3. **Within the overriding goal of fostering economic growth, the government's action plan outlined a number of key objectives. Backed by the 2011-14 PSI, these included:** (i) pursuing a prudent fiscal and debt policy and improving expenditure quality so as to maintain macroeconomic stability; (ii) raising revenue to create more fiscal space for priority spending, including additional infrastructure investment; (iii) strengthening further public financial management and governance to enhance fiscal transparency, budget planning and execution, improve the productivity of public expenditure, and reduce budgetary risks; and (iv) stimulating private sector development through structural reforms, particularly in the energy and financial sectors, and other reforms related to the business climate.

[1] Prepared by Alexei Kireyev.

A. Macroeconomic Performance

4. Senegal's macroeconomic policies supported by the PSI have remained aligned with the authorities' own development and poverty reduction strategies. The NSESD included three growth scenarios. Under the baseline, optimistic, and pessimistic scenarios, the average 2013-17 growth was expected to reach 4.9 percent, 6.8 percent and 3.2 percent respectively. The underlying assumptions of these three scenarios differed with respect to the anticipated level of financing, the absorptive capacity of the economy, and progress in implementing key reforms. The NSESD's baseline scenario was broadly in line with the PSI.

5. Senegal's actual growth performance in 2011-14 diverged substantially from all scenarios (Table 1, Figure 1). Growth projections seem to have been systematically biased upward. On average, the projection under the NSESD baseline scenario was the closest to the outcome, with the mean forecast error of only -0.4 percent, a relatively low standard deviation of about 0.4, and an approximately symmetric and relatively peaked distribution. The largest deviation between the projections and the outcome was under the updated PRSP II growth scenario, which was the authorities' central scenario with at the time of PSI request, where growth was strongly overestimated as the forecast error on average reached -2.6 percentage points with very skewed and flat distribution.

Table 1. Senegal: Growth Projection Errors
(Percentage Points)

Relative to:	2011	2012	2013	2014	Average
PRSP II update	-3.0	-2.7	-3.0	-1.9	-2.6
PSI request	-2.3	-1.3	-1.3	0.0	-1.2
NSESD optimistic scenario	-0.5	-0.3	-2.1	-1.6	-1.1
NSESD baseline scenario	-0.5	-0.3	-0.8	0.1	-0.4

6. Inflation remained subdued during most of the program period. In 2011, inflation peaked at 3.4 percent driven by a spike in international food and oil prices, and transportation costs. The authorities responded by a temporary freeze of key food prices, but later allowed a full pass-through of international food prices and resumed the adjustment of domestic petroleum product prices to reflect world prices. With several increases in the BCEAO's policy rate, lower import prices and good domestic harvests, Senegal's inflation quickly returned to the projected path and continued on a downward trend towards the end of the program.

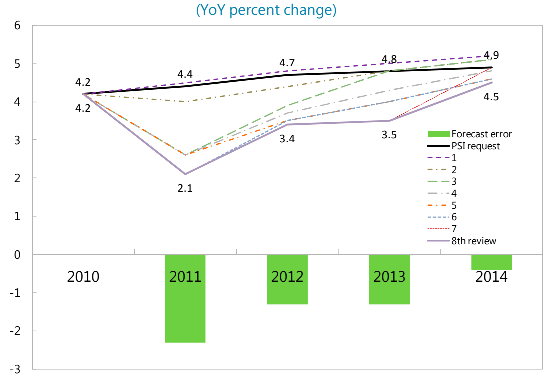
7. The authorities' fiscal performance has also diverged from their own and program projections. The authorities' PRSP II update did not include independent fiscal projections as they were fully aligned with the projections underlying the PSI request. Such projections were only published in the NSESD and included three scenarios. Under the baseline scenario, the average fiscal deficit was projected at 4.1 percent of GDP in 2013-17, broadly in line with the PSI. The deficit was supposed to expand to 5.0 percent of GDP in the optimistic scenario, as higher growth should have been financed by new borrowing, and contained at 4.2 percent of GDP in the pessimistic scenario.

Figure 1. Senegal: Macroeconomic Developments

Real growth has been systematically overestimated

Real GDP Growth

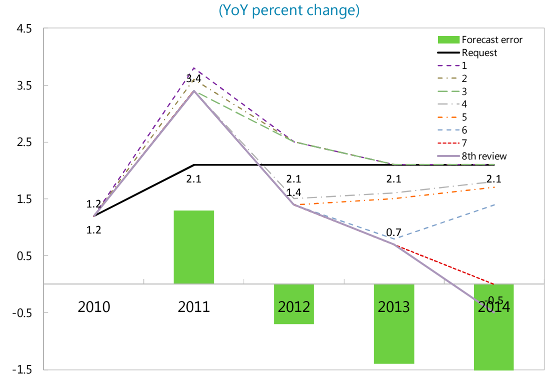
(YoY percent change)



...while inflation has been lower than expected

Average CPI Inflation

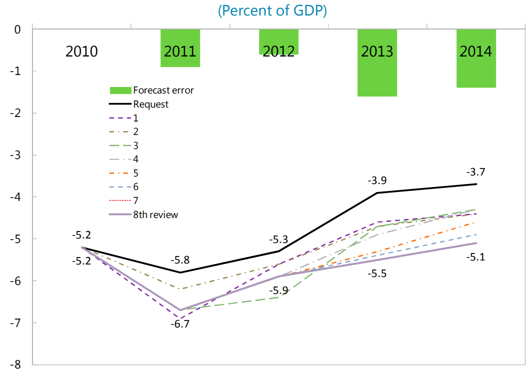
(YoY percent change)



The fiscal deficit has been substantially higher than expected...

General Government Balance

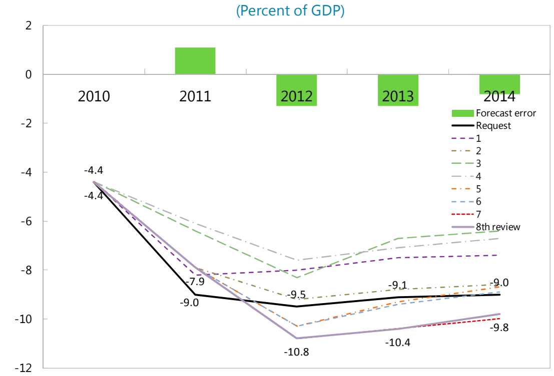
(Percent of GDP)



and contributed to the expansion of the current account deficit.

Current Account Balance

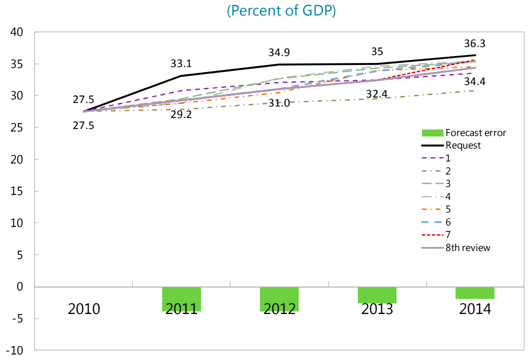
(Percent of GDP)



External debt has grown slower than projected...

External Public Debt

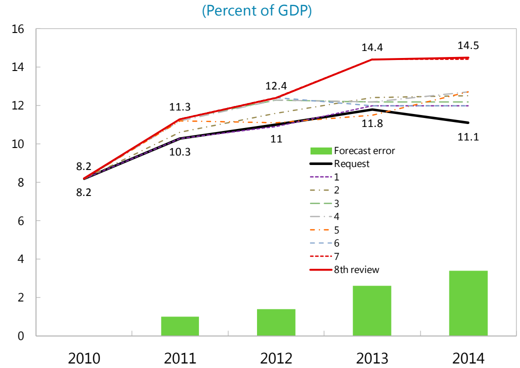
(Percent of GDP)



largely offset by a more rapid than projected accumulation of domestic debt.

Domestic Public Debt

(Percent of GDP)



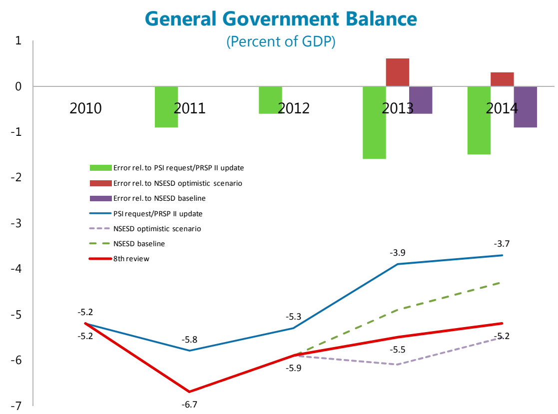
8. **By mid-2014, neither of the fiscal scenarios was in line with projections**. On average, the smallest mean errors were observed under both NSESD scenarios. The actual deficit was substantially better than projected compared to the optimistic scenario (by an average of 0.3 percent of GDP). At the same time, the deficit was considerably higher compared to both the NSESD baseline scenario and the PSI request scenario, on average by 0.4 and 1.1 percent of GDP respectively. This suggests that neither the baseline scenario nor the optimistic scenario were realistic from the outset.

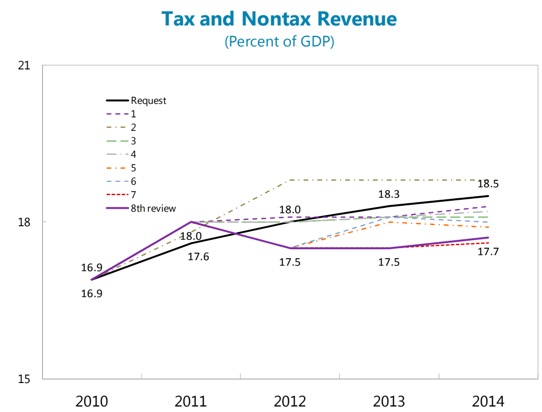
9. **The divergence of fiscal projections from targets was driven by forecasting weaknesses of both revenue and expenditure** (Figure 2). Tax and nontax revenue underperformed on average by 0.5 percent of GDP during the program period. This one-sided error in revenue projections points at a systematic revenue overestimation. The opposite is true for expenditures, which have been systematically underestimated by about 1.5 percent of GDP on average. As a result of this and the protracted revenue shortfalls and expenditure underestimations, the authorities had to make fiscal adjustments of about 2 percent of GDP each year on average, to meet the fiscal deficit target during the program period. This in turn led to high volatility in government investment, which carried substantial burden in the adjustment

Figure 2. Senegal: Detailed Fiscal Performance

Realized fiscal deficit differed substantially from all scenarios….

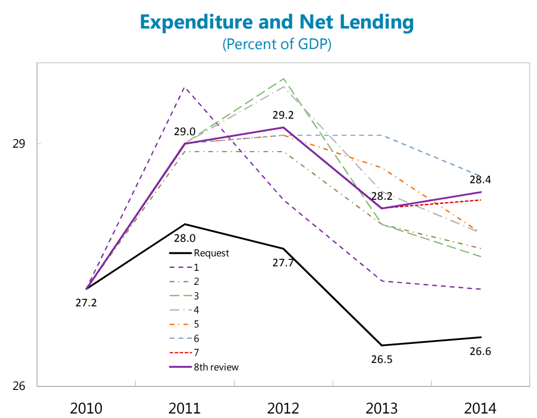
…as revenue collection was lower than expected…

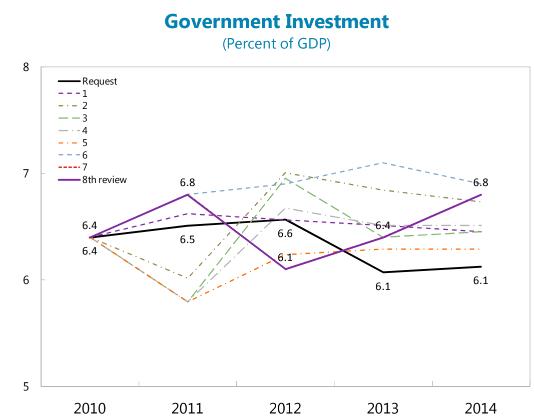




…and the overall expenditure were systematically underestimated.

Investment was used as the main adjustment expenditure item.





10. The current account deficit has been systematically underestimated during the program period. The average difference between the projection and the outcome was 0.6 percent of GDP, strongly skewed and peaked. On one hand, developments in the current account broadly mirrored and were driven, at least in part, by the evolution of the fiscal deficit, although the divergence from the baseline in the current account was somewhat lower. On the other hand, during the program period Senegal was hit by exogenous shocks, related mainly to sharp increases in imported food and oil prices, and regional geopolitical tensions, which also contributed to the expansion of the current account deficit. The private sector offset at least part of these exogenous shocks by adjusting its saving investment balance accordingly.

11. Finally, the rate of accumulation of domestic public debt has been higher than program projections. The overall average deviation from the projections is relatively small, about 0.7 percent of GDP, and the trajectory of the overall debt accumulation was below the projected trend during the first half of the program. However, it substantially exceeded the projected level towards the end. External debt accumulation was substantially lower than projected, by about 2.8 percent of GDP on average each year. It was explained mainly by the authorities' prudent policies, low availability of concessional financing, and conditionality on external debt included in the PSI. At the same time, the authorities extensively used domestic and regional financing, which led to a rapid domestic debt accumulation at a rate exceeding the baseline projections by 2.1 percent of GDP.

12. Several factors may explain the systematic deviations of key macroeconomic variables from their projected path during the 2011-14 PSI.

- *First, protracted delays in key structural reforms*. Higher growth, strong revenue collection, and lower fiscal deficits, required ambitious structural reforms. Most structural reforms, in particular related to the energy sector and public financial management, have been delayed, scaled down or implemented inconsistently, which weighed heavily on growth and revenue.

- *Second, systematic upward biases in the authorities' macroeconomic projections*. In the recent past, growth has been projected to exceed its historically observed averages and even the empirically estimated potential. To achieve such ambitious growth rates would have required either a substantial increase in total factor productivity, for which the potential is limited without a profound economic modernization, or new labor and capital, which is held back by the lack of productive employment opportunities and financial constraints.

- *Third, the external environment has been less favorable than anticipated.* Senegal was negatively affected by several episodes of oil and food prices increase in international markets, which led to both lower growth and unanticipated increases in fiscal subsidies. On the regional level, Senegal export demand was somewhat affected by regional crises in Côte d'Ivoire and Mali.

- *Finally, the domestic political cycle did not allow for the vigorous pursuit of reforms that could have had social impact.* For almost a year ahead of the March 2012 presidential elections and for several months ahead of the June 2014 local elections, most structural reforms moved ahead much slower than anticipated and the most critical were postponed to the post-election period.

B. Program Performance

13. Senegal's performance under the 2011-14 PSI program has been satisfactory (Figure 3). After initial difficulties in meeting the assessment criteria during the first half of the program period, program implementation improved during the second half. The quantitative assessment criteria were largely met, and only three out of 48 quantitative assessment criteria were missed, in both cases by small margins. Specifically, the authorities missed (i) the AC on the basic fiscal deficit by 0.2 percent of GDP because of lower than projected oil revenue (First Review); (ii) the overall fiscal deficit target by 0.4 percent of GDP because of administrative weaknesses leading to expenditure overruns (Third Review); (iii) the ceiling on non-concessional borrowing by 0.4 percent of GDP due to the failure to classify properly of a loan with 11 percent grant element as non-concessional (Eighth Review).

14. **The authorities' capacity to control expenditure strengthened during the program period, although serious deficiencies remain**. Fiscal deficit targets have been met, however, always at the expense of curtailing expenditure, mainly domestically financed investment, towards year-end. At the same time, weaknesses in revenue collection have persisted and the indicative floor on tax revenue was missed by 1.3 percent of GDP during the Seventh Review. The indicative ceiling on the share of public contracts signed by a single tender was missed by a small margin at the Fifth Review reflecting mainly coordinating difficulties in the procurement process.

15. **The implementation of structural reforms has been uneven**. Of the 35 structural measures included in the program, about three-quarters have been implemented, either on time or with delays. However, the remaining measures either have not been done or dropped altogether. All measures aimed at controlling the fiscal deficit, improving tax revenue, and enhancing the quality of expenditure, and of debt management have been broadly implemented, although some with substantial delays. This was especially the case for PFM during the program's second half. The single treasury account has not yet been implemented, and the continuous benchmark on the cost-benefit analysis of the creation of new agencies was missed. As no new projects exceeding CFAF 10 bn were included in the 2014 budget, the benchmark on their cost-benefit assessment could not be met, while the roll out of the new payroll software was met with a substantial delay. Structural problems persisted in the area of private sector development, business climate, investment and infrastructure. Most were related to delays in reforms to the energy sector, electricity subsidies and other infrastructure investment.

Figure 3. Senegal: Performance Under the 2011-14 PSI

Quantitative assessment criteria and indicative targets have been largely met, although often with last minute expenditure cuts and other adjustments

Quantitative Assessement Criteria and Indicative Targetes

Met | Not met

	First review			Second review			Third review			Fourth review			Fifth review			Sixth review			Seventh review			Eighth review		
	End-Dec. 2010			End-June 2011			End-Dec. 2011			End-June 2012			End-Dec. 2012			End-June 2013			End-Dec. 2013			End-June 2014		
	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.	Prog.	Adj.	Act.
Assessment criteria																								
Floor on the basic fiscal balance	-119		-133	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Floor on the overall fiscal balance	...	...	...	-237	...	-155	-427		-455	-213	-181	-102	-425	-420	-420	-203	-190	-155	-406	-420	-400	-198	-183	-170
Ceiling on the contracting or guaranteeing of new nonconcessional external debt (US$ millions)	0	...	0	500	...	300	500	...	300	500	...	300	500	...	300	800	...	300	800	...	506	1,006	...	1,064
Ceiling on spending outside normal procedures	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0
Ceiling on government external payment arrears	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0	0	...	0
Ceiling on the amount of the budgetary float	50	...	48	50	...	45	50	...	50	50	...	40	50	...	48	50	...	46	50	...	30	50	...	46
Ceiling on nonconcessional debt with a minimum grant element of 15 percent	0	...	0	30	...	0	44	...	0	44	...	0	44	...	0	67	...	0	132	...	53	224	...	...
Indicative targets																								
Quarterly ceiling on the share of the value of public sector contracts signed by single tender (percent)	20		6	20		6	20		16	20	...	11	20	...	24	20	...	14	20	...	8	20	...	8
Floor on social expenditures (percent of total spending)	35		41	35		41	35		37	35	...	35	35	...	41	35	...	35	35	...	38	35	...	38
Floor on tax revenue	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	1,434	...	1,343	730	...	746

Structural performance under the program has been mixed as many measures have been implemented with substantial delays

Structural Benchmarks, 2011–2014

Met | Met with delay | Not met by review deadlines

	First review	Second review	Third review	Fourth review	Fifth review	Sixth review	Seventh review	Eighth review
	12/31/2010	6/30/2011	12/31/2011	6/30/2012	12/31/2012	6/30/2013	12/31/2013	6/30/2014
Budget deficit, tax revenue, quality of expenditure, and debt management								
Prepare an action plan to achieve realistic budgeting for utilities by all ministries								
Adoption by the Council of Ministers of the budget execution law								
Issue a decree on the committee monitoring budget execution								
Create procedures for the entity responsible for the domestic and external public debt								
Introduce a unique taxpayer identification number in customs operations								
Operationalize the new public debt directorate								
Prepare a medium-term debt strategy								
Finalize the new tax code and submit it to parliament								
Submit new Customs Code to Parliament								
Public financial management								
Submit a tax policy reform strategy to the Council of Ministers								
Create a new entity for managing domestic and external debt and market interventions								
Settle the final amounts of extra budgetary expenditure and publish a press release								
Formulate a strategy and timetable for the establishment of a single treasury account								
Finalize the single treasury account								
Adoption of the draft law transposing the directive on the transparency code.								
Launch and complete a comprehensive survey of agencies and their missions.								
Publish information on land transaction of the government.								
Produce a plan to restructure all agencies and comparable entities.								
Use cost-benefit assessment for investment projects exceeding CFAF 10 billion								
Roll out the new payroll management software								
Transmission to parliament of a draft law on assets disclosure								
Presentation by the five largest agencies of strategies and implementation of contracts.								
Perform cost-benefit analysis before the creation of new agencies								
The cost-benefit analyses on investment projects will be sent to the National Assembly								
The 2015 draft budget law will include an annex with the full list of agencies								
Private sector development, business climate, investment and infrastructure								
Prepare a restructuring plan for the energy sector								
Publish monthly on the government's website information on the extension of the highway								
Publish monthly information on the Energy Sector Support Fund								
Finalize legislation fostering the development of financial leasing								
Finalize an audit of the resources allocated to the extension of the highway and publish it								
Finalize a study of the resources used in the microfinance sector and their impact								
Adopt an action plan to tackle current level of subsidies to electricity consumers								
Prepare a project evaluation guide								
Roll out on-line filing and on-line payment of taxes for large enterprises								
Roll out on-line filing and on-line payment of taxes for all tax payers in the Dakar area								
The reports of the SENELEC performance contract and the audit will be published								
The 2015 draft budget law will include an annex on budget support for energy prices								

Although there were fewer benchmarks during the second half of the program, performance remained mixed.

Number of Structural Benchmarks per Review

	First review	Second review	Third review	Fourth review	Fifth review	Sixth review	Seventh review	Eighth review
Total number of benchmarks	6	6	7	3	3	5	5	5
Met	4	3	2	1	1	0	1	2
Met with delay	2	2	2	2	1	3	2	
Not met	0	1	3	0	1	2	2	
In percent of total	100	100	100	100	100	100	100	100
Met	67	50	29	33	33	0	20	40
Met with delay	33	33	29	67	33	60	40	0
Not met	0	17	43	0	33	40	40	0

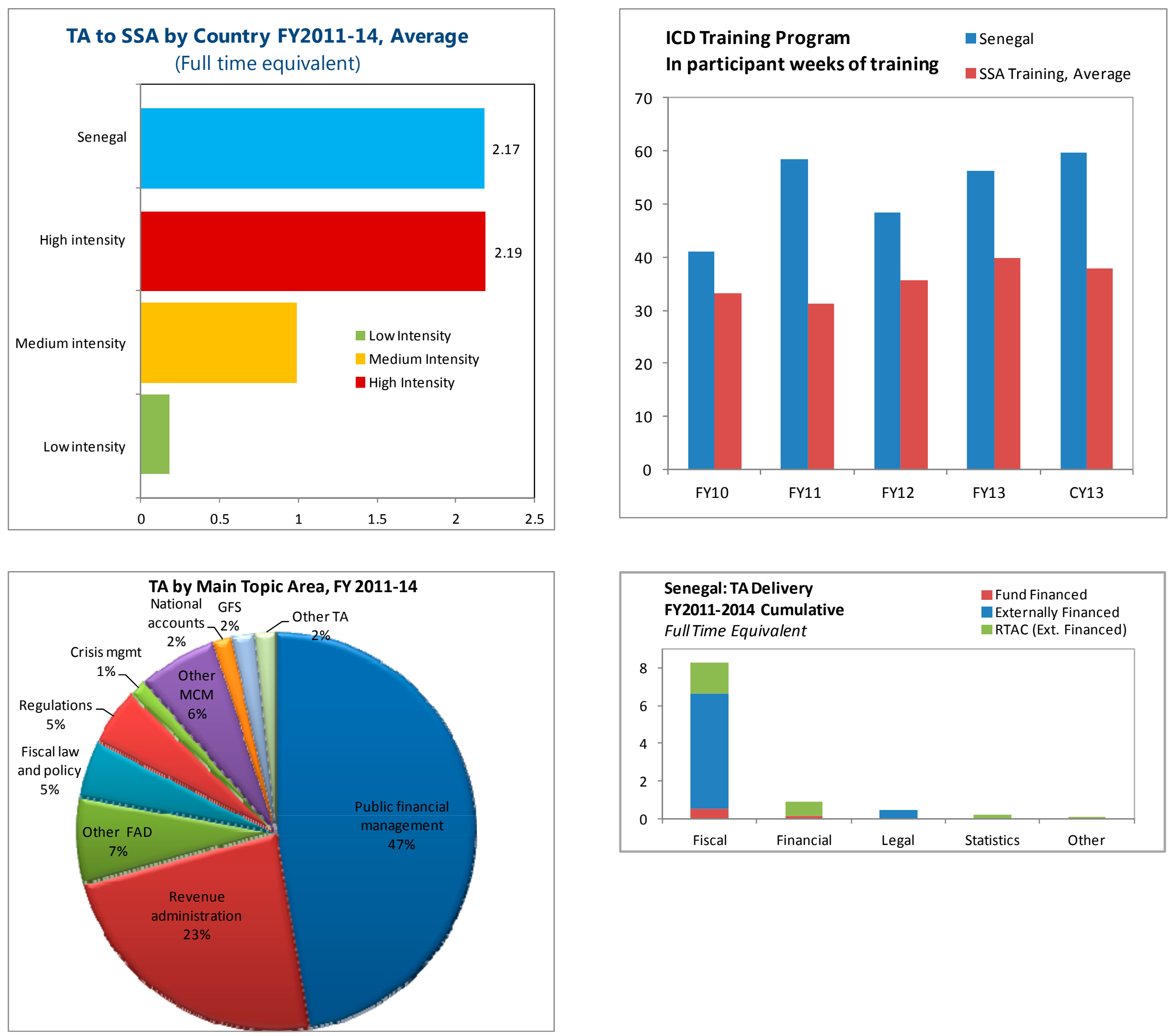
16. PSI design and conditionality has appropriately focused on areas of Fund expertise and critical importance for Senegal. The program has been mainly fiscal in nature, targeting both fiscal and debt sustainability. At the 1st review, the main program AC was changed from the basic balance to the overall fiscal balance because of an increased focus on debt sustainability. To address difficulties with revenue collection, an indicative target on tax revenue was introduced at the 6th review. At the same time, substantial flexibility has been built into the program by way of adjustors on the fiscal deficit to allow the full use of all concessional financing. The ceilings on non-concessional and semi-concessional external financing have been increased several times to allow Senegal to make full use of additional resources to finance investment in macro-critical areas, such as energy and infrastructure.

C. Technical Assistance

17. During the 2011-14 PSI, Senegal has been a high-intensity user of the Fund's technical assistance (TA) (Figure 4). In terms of years of staff/expert time (full time equivalent, FTE), Senegal ranked in the top quartile among SSA countries, with an average of 2.2 years of TA provided during the PSI program period. In terms of volume, TA to Senegal substantially exceeded that to all other WAEMU countries, with the exception of Togo, and was comparable to the TA provided by the Fund to Nigeria, DRC and Mozambique. On average, Senegalese officials received more training provided by the Fund's Institute for Capacity Developments (ICD) compared to an average SSA country.

18. Fund TA to Senegal has focused on several priority areas. About 90 percent was devoted – directly or indirectly - to public finances, compared to 50 percent in other SSA countries. To strengthen Senegal's PFM, the Fund's TA has focused on reinforcing budget accounting, improving the coverage and timeliness of fiscal reporting; strengthening cash management, the establishment of a single treasury account and the implementation of the new WAEMU PFM directives. Priorities in the TA related to tax policy have included support for the development of a new tax code, reforms to the VAT, particularly the VAT credit system and exemptions, the personal income tax and the taxation of the banking system. Reforms in tax and customs administration have been geared toward modernizing their functional structures (e.g. establishment of a medium-sized taxpayers' office in Dakar) and strengthening risk based audits to improve compliance. TA on debt management has contributed to the establishment of a single debt management unit in the ministry of finance and the development of a new debt management strategy. Finally, Senegal has continued to strengthen its macroeconomic statistics, including the production of quarterly national accounts and the introduction of a producer price index, with the ultimate objective of complying with Special Data Dissemination Standards. As Senegal is member of the WAEMU, its TA needs in the monetary and financial sector areas have been addressed mainly at the regional level.

Figure 4. Senegal: Fund's Technical Assistance



D. Conclusions

19. Senegal's macroeconomic performance under the PSI-supported program was satisfactory. Key program goals –growth, fiscal and debt sustainability—were achieved, and the overall macroeconomic stability preserved, although outcomes were less favorable than initially programmed. Consequently, the achieved growth rate and fiscal policies were not sufficient to make a visible dent in poverty reduction and improve other social indicators. While the authorities' own growth and poverty reduction strategies had set the appropriately high targets to achieve the desired growth, fiscal, and social outcomes, the projections turned to be excessively ambitious and incoherent with historically observed trends. Unrealistic expectations have led to systematic upward biases in program projections of key macroeconomic variables.

20. Senegal's performance under the PSI-supported program was an important guiding post for domestic reforms and their external support. The satisfactory macroeconomic performance and the compliance with key quantitative assessment criteria were somewhat overshadowed by slow program implementation on the structural side. There is a strong case for continued active cooperation between the Fund and Senegal, either in a program or regular surveillance context.

21. Fund TA to Senegal has been helpful in accompanying important reforms. While the priority areas should remain broadly the same, more emphasis is needed on the implementation and follow-up of the earlier advice. Tax collection and expenditure rationalization are the two priority TA areas for the short term that could contribute to a more manageable fiscal performance, reduce the need for disruptive ad-hoc adjustments and improve overall fiscal predictability. Additional TA in public debt management and strategic fiscal policy and PFM issues will be needed. Emphasis on public investment management may be called for in view of the planned increase in infrastructure spending under the PSE.