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M. QURESHI'S
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May 3 - June 16, 1989

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June 16,1989

M. Qureshi

THE WORLD BANK
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee Meeting to Consider
GUINEA - Initiating Memorandum for Private Sector Promotion Credit

Held on June 16, 1989 in Room E-1243

A. Present

Committee	Others
Messrs. M. Qureshi (Chairman)	Messrs. E. Grilli (EAS)
E. Barandiaran (LACVP)	U. Thumm (EAS)
S. Asanuma (ASIVP)	T. Baudon (OPNSV)
P. Hasan (EMNVP)	K. Siraj (CODOP)
J. Linn (DECVP)	P. Dufour (FRM)
H. Scott (LEGVP)	I. Serageldin (AF1DR)
B. Kavalsky (FPRVP)	R. Westebbe (AF1DR)
	C. Poortman (AF1IE)
	M. Wormser (AF1IE)
	J. Deschamps (AF1IE)
	J. Walters (AF1CO)
	R. Lall (AF1IE)
	D. Singh (AF1DR)
	F. Kaps (AF1CO)
	F. Earwaker (SPRPA)
	(Ms.) M. van Beek (LEGAF)
	H. Crevier (SECGE)

B. Issues

1. The meeting was called on the IM for a proposed Private Sector Promotion Credit to Guinea in an amount of $35 million. The discussion followed the agenda prepared by the Economic Advisory Staff.

2. Regarding the country strategy, the Region explained that the proposed operation, while not explicitly dealt with in the 1988 CSP, had been in the forefront of the policy dialogue and country assistance strategy all along. It was further noted that one of the strategy's central concerns was the stimulation of supply response and, while this concern was initially to be addressed through a credit line operation, the reform program had now been "repackaged" under the umbrella of the proposed private sector operation. With regard to IDA's financial contribution and burden sharing, the Region explained that the financing gap before taking grants into account was actually larger than the respective line item in table 2, appendix 1. On the basis of the larger financing gap, IDA's contribution was only about one-third. In this context, the Region also noted that, after some difficulties in 1988, overall program performance was now satisfactory, with strong fiscal measures and appropriate exchange rate management. The results in terms of declining inflation and accelerating growth (with visible movement in rural areas) were also encouraging.

3. In a different context but related to the country strategy aspects, a committee member raised the question how the long-term nature of the reforms could be reconciled with the quick-disbursing character of the proposed loan and which other instruments could be used, including technical assistance. The Region replied that most of the reforms would indeed be undertaken during the disbursement period of the loan as they are already being supported with considerable technical assistance under an existing credit and that future operations, in particular the next SAL, would allow to follow up and to continue to support the reform process.

4. Regarding the scope of the reforms, the Region stressed that some of the proposed measures were indeed economy-wide and not limited to the industrial and financial sectors, but that the reform effort had to be concentrated on industry as this sector lagged behind others. In response to a specific question, it was mentioned that the insurance sector had already been reformed, with private insurance services now being available, and that transport sector reforms were under way.

5. The proposed reforms of the investment code triggered some discussion of the overall approach to the improvement of the enabling environment for investments. Questions were raised as to whether, in the spirit of the reforms, one should not move further away from specific interventions; whether the proposed reforms were necessary or sufficient to obtain the desired supply response; and whether other measures such as the strengthening of the legal system (including the establishment of a proper legal profession) to ensure adequate enforcement of new laws and regulations or transport infrastructure and services were not equally important. The Region explained that many complementary actions were supported in parallel through other operations. Moreover, it was stressed that reforms take time to bear fruits: while the highest levels of the administration were fully committed to the reforms the lower-level echelons were still staffed with pre-reform civil servants whose attitudes could only be changed over a prolonged period of time. The Chairman concluded this part of the discussion by emphasizing the importance of regulatory reform as a key step towards the improvement of the enabling environment, while stressing at the same time the need for supplementary measures in infrastructure and education.

6. With regard to the financial system, the key questions were whether the reform should go further towards a more complete liberalization of the system, including greater competition to stimulate higher savings and greater availability of credit. In response to these questions, the Region reminded those present of the great achievements of the past few years during which the banking system was thoroughly overhauled, private banks were established and interest rates partly freed and adjusted to levels close to inflation (which had been coming down as a result of improved macroeconomic management). In response to a specific question, it was noted that credit availability to the private sector was not constrained by excessive credit expansion to the public sector, which had been reduced in line with progress on the macroeconomic front, but rather by banks' willingness to lend owing to legal difficulties. These difficulties would now be addressed under the proposed operation.

7. Finally, the question was discussed whether disbursements could be made against a positive list of imports. The Chairman accepted the Region's explanation that the loan supports broad-based, not sector specific reforms and that a positive list of imports would be impractical.

C. Decisions

8. The Chairman concluded the meeting by expressing his satisfaction with the proposed program, while at the same time urging the Region to make the reform program as comprehensive as possible and to push as much as possible for further financial liberalization. Administrative fiat in setting interest rates should be limited to a minimum, perhaps by establishing very high interest ceilings to allow actual rates to be set through a market-based process.

UThumm:vlw
June 19, 1989

Mr. Qureshi

R2060706

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 7, 1989

TO: Operations Committee

FROM: Anandarup Ray, Acting Director, EAS

EXTENSION: 78073

SUBJECT: GUINEA: Initiating Memorandum for a Proposed $35 Million Private Sector Promotion Project, Agenda

1. The Operations Committee will meet on Friday, June 16, 1989 at 12:00 noon in Room E-1243 to discuss the IM for a proposed $35 million Private Sector Promotion Project[1] to Guinea. The Operations Committee may wish to discuss the issues as set out in paragraphs 5-10.

Background

2. As a result of more than two decades of pervasive economic mismanagement, Guinea plunged into a deep economic, financial, and social crisis. Since 1985, the new Government has undertaken a radical and far-reaching economic reform program that has been supported by two SACs from IDA and various IMF arrangements, including two SAF arrangements. After major policy slippages during 1988 which resulted in financial difficulties and a depletion of reserves, the program was brought back on track (which allowed IDA to make SAC II effective in March 1989).

3. While the initial supply response to the policy reforms was impressive (as manifest in a resumption of growth at rates on the order of 5-6 percent), there remain many obstacles to private sector confidence and subsequent engagement. There are still important macroeconomic imbalances (as signaled by 27 percent inflation during 1988) which are only gradually improving, and there is still pervasive government intervention which results in significant distortions of incentives and leaves room for discretionary and arbitrary decisions.

4. Macroeconomic imbalances and broad structural problems (such as trade restrictions and distortions, exchange rate management, public enterprise and civil service problems, etc.) are addressed through the second-year SAF arrangement with the Fund and IDA's SAC II. The proposed operation would take the reform process one decisive step further into the regulatory environment for private sector activities. A number of issues arise, however, with regard to the general direction of the proposed credit and the strength of specific reform efforts.

Country Strategy and Credit Amount

5. The IM portrays the proposed credit as complementary to the two SACs as it would address regulatory issues and thus contribute to an

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1 In view of the Board discussion on the Benin Health Sector Project, the proposed credit should perhaps be called Private Sector Promotion Credit to avoid that it could be mistaken for a normal investment project credit.

improvement of the business environment and stimulate the private sector supply response. As this operation is not mentioned in the January 1988 CSP (nor for that matter, the financial sector adjustment operation which was at its origin), the Region could be asked to bring the Committee up to date on the currently pursued strategy, particularly with regard to adjustment lending (SAC III, additional SECALs) against the country's overall external financing requirements.

6. The Region proposes a $35 million credit. The amount is determined on the basis of the country's external financing gap during 1990-91 on the order of $110 million (appendix 1, table 2). Together with the proposed Education Sector Adjustment Credit, IDA balance of payments support would amount to over 50 percent of the estimated 1990-91 gap. This raises the question of adequate burden sharing among creditors and donors.

Scope of the Reforms

7. The proposed operation is called a private sector promotion project. Yet the reforms are basically limited to the regulatory environment for the industrial sector, including financial sector reforms that would ultimately facilitate term financing for industry. The private sector is clearly broader than industry. A question to be asked would, therefore, be whether the scope of the reforms could not be broadened so as to facilitate activities also in other sectors (agriculture, mining, services, particularly transport and insurance).

Regulatory Reforms

8. The proposed regulatory reforms are quite comprehensive and cover business licensing and registration, labor market regulations, land and property rights, administration of the turnover tax, customs administration, investment promotion, and an improved administration of the existing investment code (which was reformed in 1987 with IDA support). The reforms seem to be well focused and, if fully implemented, would significantly improve the business environment. With regard to the investment code, the main problem--as stated by the Region--is the granting of tax exemptions on an ad-hoc basis outside the established norms of the code. It is proposed to establish clear eligibility criteria and improve the administration so as to limit the incentives to investors meeting those criteria. The question arises, however, whether in a more liberal environment one would not want to move away, over time, from any special incentives for perceived priority activities, i.e., ultimately abolish the investment code and replace it by a more reasonable and generally applicable tax system. Could the ground be prepared for such a move through the proposed operation?

Financial Sector Reforms

9. Although completely overhauled since the onset of the economic reforms in 1985, the financial sector is quite weak and not adequately regulated and supervised. A substantial portion of commercial banks' portfolio (30-50 percent) is not performing (paragraph 55 of the IM). Moreover, the financial system seems to capture less than 10 percent of non-government savings (estimate based on 1988 numbers) and intermediation seems to be inefficient and at high cost. The proposed reforms cover

reviews (and possible administrative adjustments) of the level and structure of interest rates (both deposit and lending rates) and more adequate prudential regulations and their enforcement by the Central Bank. The fundamental question to be asked is whether the proposed reforms go far enough towards liberalizing the financial system and making it more efficient in mobilizing and allocating resources. The Region could be asked to encourage a more comprehensive and adequately sequenced reform (ultimately leading to free interest rates and the complete elimination of subsidies for preferential credit). It would be important that such reforms would be backed by a vigorous implementation of the medium-term macroeconomic program, particularly the fiscal adjustment program to bring down inflation, as outlined in the PFP, and possibly by a further liberalization of the exchange system, including the progressive opening of the capital account.

Eligible Imports

10. Although not spelled out specifically in para. 79, it seems that the Region proposes to finance general imports subject to the usual negative list. The question arises whether it might be practical to disburse against a broad positive list of imports, e.g., to satisfy needs of the industrial sector (and possibly other sectors if they are specifically covered).

OC Members

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Rajagopalan, Fischer, Shihata, Wood, Vergin.

cc: Messrs. Lee (COD); Shakow, Liebenthal (SPR); Holsen (CEC); Rao, Steer, (FRS); Burmester/Thahane (SEC); Baudon (SVPOP); Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Frank (CFP); Parmar (CIO); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); (Ms.) Haug, Tanaka (EXC); Robless (OPNMS); Agarwala, AFRCE; O'Brien, Serageldin, Singh, Westebbe, Landell-Mills, Poortman, Kaps, Wormser, Deschamps, AFR.

UThumm:vlw

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

890530003 1.

DATE: May 24, 1989

TO: Mr. Moeen Qureshi, Senior Vice President, Operations

FROM: Edward V.K. Jaycox, Regional Vice President, Africa 5/25

EXTENSION: 34752

SUBJECT: GUINEA - Initiating Memorandum for a Private Sector Promotion Project

1. Based on the attached Initiating Memorandum, we are hereby seeking approval by the OC to appraise a US$35 million IDA Credit in support of a Private Sector Promotion Project in Guinea.

Overall Rationale and Strategy

2. Guinea's new Government has since 1985 undertaken a drastic economic reform program covering money and banking, pricing, trade and tariff policy, the civil service and state enterprises, and the legislative environment. However, despite the improved incentive framework established under the two SALs, the supply response from the private sector has so far been disappointing, and new investment remains weak. This sector operation is intended to complement the macroeconomic adjustment effort by focussing on the measures required to take full advantage of the enabling environment created by the reform program.

3. The project's objective will be to use the private sector as an engine for renewed growth and investment, by establishing conditions that will restore confidence in the local business environment. The program aims at improving the overall investment climate, but will focus in particular on constraints that impede investment/capital formation in the manufacturing sector, where performance has been most disappointing.

Key Components

4. The project's key components will include:

(i) Simplification of the legal/regulatory framework: streamlining of enterprise establishment and registration procedures and of labor regulations; progress in resolving the land and property title issue.

(ii) Enhancement of the overall incentive structure: improvement in the effectiveness of the new tariff and investment codes; reduction of distortions related to the ad hoc award of exemptions and other special incentives outside of the Investment Code's framework; and reinforcement of Customs Administration.

(iii) Increased effectiveness of the institutional framework for investment promotion: clarification of the mandates of the various institutions involved; enhanced operational efficiency.

(iv) Improving the policy and operational framework in the financial sector: deepening of interest rate reform aiming at a more effective resource mobilization effort on the part of the banks; a rationalization of credit markets, including the consolidation of discount/refinancing windows; regulation limiting access by Treasury to advances at the Central Bank; establishment of an improved legal framework surrounding the issue of bank guarantees; and substantial strengthening of the Central Bank's capacity to monitor activity in the banking sector.

Financing

5. An IDA Credit of US$35 million would be made to the Government at standard IDA terms in support of the proposed reform program. This amount would represent 32 percent of Guinea's anticipated financing gap for 1990-91. The Credit would be disbursed over a 12-month period extending to March 1991, with a first tranche being made available at effectiveness and a second tranche upon satisfactory progress in implementing selected actions described in the Government's Letter of Sector Development Policy.

Risks

6. The risks involved in this Operation are two-fold: (1) that, given the long-standing negative attitudes towards the private sector, the new set of reforms will not be forcefully implemented by government officials directly in touch with business operators; and (2) that despite the new train of measures, private promoters will maintain a wait-and-see attitude towards Guinea. The first type of risk should be offset however by the commitment felt at the highest level of Government to push forward the reform program. Also, the project does not only focus on the introduction of a more responsive regulatory framework per se, but also attempts to improve the administration's capacity to monitor and implement the proposed reform program. In this respect, technical assistance will play a key role in improving government responsiveness to private enterprise needs, particularly within the Ministry of Finance, the Customs Administration, and the Central Bank. As for the second type of risk, given Guinea's still largely untapped economic potential, it is reasonable to assume that promoters will respond favorably to the improved investment climate to result from this program.

Co-financing

7. This operation will aim at restoring conditions of growth in the productive private sector, and is therefore expected to attract co-financing as a central piece of the Guinean adjustment strategy. The Caisse Centrale has expressed an initial interest in participating in this operation. Further discussions with the Caisse Centrale will be held as part of the appraisal mission. Other co-financing opportunities (including the European Investment Bank) will be explored in the coming months.

Coordination with the IMF and IFC

8. The proposed program has been prepared in close coordination with the IMF, and its thrust is in line with the content of the PFP. In particular, the IMF is being consulted with regard to detailed proposals pertaining to proposed policy changes in the areas of interest rate reform, monitoring and supervision of the banking sector, and tariff protection. The program is also being designed in close liaison with FIAS, which completed a comprehensive review of the determinants of Guinea's investment climate in September 1988. The content of the proposed Operation is fully consistent with recommendations made by FIAS in their review.

9. We believe the proposed Operation offers strong potential to improve the climate for private investment in Guinea, and thus recommend proceeding with its appraisal.

Attachment.

Distribution:

Operations Committee Members:

Messrs: Qureshi (SVPOP); Husain (LACVP); Jaycox (AFRVP); Karaosmanoglu (ASIVP); Thalwitz (EMNVP); Rajagopalan (VPPRE); Shihata (VPLEG) (2); Wood (VPFPR); Vergin (OPNSV).

Other Attendance:

Messrs. Lee (CODDR); Dubey (EASDR); Shakow (SPRDR); Holsen (CECDR); Rao (FRSDR); Baneth (IECDR); Burmester, Thahane (SEC); Liebenthal (SPRPA); Steer (FRS); Baudon (SVPOP).

For Information only:

Messrs./Ms. Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Frank (CFPVP); Parmar (CIOVP); Pfefferman (CEI); Baneth (IEC); Kavalsky (FRM); Haug, Tanaka (EXC); Robless (OPNMS); Agarwala, O'Brien (AFRCE); Denning, Ohri (AFRVP); Wyss (AFTDR); O'Brien (AFRCE); Schloss (AFTIE); Sarris (AFTTF); Serageldin, Singh, Westebbe (AF1DR); Landell-Mills, Kaps, Kuoh, Tuluy, Walters (AF1CO); Poortman, Allaoua, Deschamps, Lall, Williams, Wormser (AF1IE); Cleaver (AF1AG); Palein (AF1PH); Guislain, van Beek (LEGAF); Guillou (LOAAF).

JJD:

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THE WORLD BANK

Operations Committee

CONFIDENTIAL

Minutes of the Operations Committee to Consider
CENTRAL AFRICAN REPUBLIC - Natural Resource Management Project Initiating Memorandum

Held on Friday, June 16, 1989, in Conference Room E1243

A. Present

Committee		Others	
Messrs.	M. A. Qureshi, Chairman	Messrs./Mmes	I. Serageldin, AF1DR
	H. N, Scott, LEG		E. Grilli, EAS
	F. X. Colaco, PREVP		K. M. Cleaver, AF1AG
	B. G. Kavalsky, FPR		R. M. Westebbe, AF1DR
	M. J. Gillette, AFR		D. D. Singh, AF1DR
	S. Asanuma, ASI		S. J. Ettinger, CODOP
	P. Hasan, EMN		G. P. Sicat, EAS
	E. E. Barandiaran, LACVP		T. Mpoy-Kamulayi, LEGAF
	H. Vergin, OPNSV		F. H. Kaps, AF1CO
			P. Alba, AF1CO
			F. J. Earwaker, SPRPA
			P. J. Dufour, FRM
			H. P. Crevier, SECGE
			T. Baudon, OPNSV

B. Issues

1. The Operations Committee relied on the agenda proposed for the meeting by EAS. The main issues discussed covered: (a) the nature of hybrid operations, especially in cases when other donors are co-financing a large element of the quick disbursing portion; and (b) sector issues related to natural resource management and environmental protection.

Hybrid Projects

2. The Committee discussed first the issue suggested by the Region, which was how to treat a quick disbursing element of a hybrid operation where all the fast disbursing funds were to be provided by other donors. The Region stated that funds from the Special Program for Africa (SPA) co-financiers would be available to finance the quick disbursing portion of the project. Two issues then arose: (a) Could IDA have a triggering function without any IDA funds being involved?; and (b) Would IDA investment financing be affected if the macro framework were to go awry? The region felt that some IDA funds were required to enable it to monitor and trigger tranche releases, even though the bulk of the resources would be provided by SPA. The Region

also suggested that since the SPA would not provide resources to a country when its macro-economic adjustment program was off track, no quick disbursing resources would be released to the country in these circumstances. In this sense, it was possible to separate the quick disbursing portion of the Credit from the investment project component.

3. The Chairman remarked that hybrid investment operations are undertaken with the view that they are strongly linked to macro-economic conditionality. Quick disbursing funds are made available to support the conduct of a policy dialogue with a country. Therefore, to weaken the links between the quick disbursing loan and the investment operation would mean to untie that cohesion. He recognized that there exists different instruments for funnelling Credit to a country, but once an hybrid Credit instrument is chosen, the quick disbursing and investment components should not be treated as if they were separate. He further suggested that if the problem were simply that of using SPA resources to provide balance of payments support, it would be possible to achieve the objective linking additional quick disbursing funds to an adjustment and not to an investment operation.

4. The Region suggested that in the case of small countries with relatively weak institutions, the performance under a SAL could be weak or inadequate and yet they may still need fast disbursing assistance. In such situations, SPA financing through a SAL would not be possible since there would not be enough SAL operations that could be undertaken. The funding to these countries would therefore become lumpy and not available in the amounts needed. To overcome this problem, there would be some need to distribute donor funding over time, preferably linked to investment operations.

5. The Chairman stressed that the issue was not the country size. There would be no problem with going to the Board with a request to finance a balance of payments gap with a second tranche or even an additional third tranche of an adjustment operation, if it could be justified. The issue was one of being flexible with the instruments available and as the needs arose, but IDA could not be flexible on the policy conditionality which could constitute material deviation from the intent of the operation. The choice of the hybrid instrument means that there must be clear links between the macro-economic conditions and the investment program. Thus, insofar as the instrument, the Region could choose to proceed with a quick disbursing operation involving SPA co-financing, but with the condition that a satisfactory macro-economic framework is put in place and with IDA contributing some funds (even if small) for the quick disbursing component. Otherwise, a new vehicle had to be chosen. He thought that donors might find it useful to piggyback on IDA operations in order to add effectiveness to their assistance. In any case, IDA involvement was essential.

6. A member pointed out that while the strong link between policy conditionality and the investment project existed in the case of hybrid operation, IDA could not technically stop the disbursement on the investment side once the Credit was given even if policy conditions for the fast disbursing side were not satisfied. The Chairman agreed but noted that adjustment operations seldom extended beyond 18 months' time and that, therefore, the balance of the investment program would

continue after the particular issues pertaining to the quick disbursing element had been resolved, one way or the other. Furthermore, this set of questions were the same whether this disbursement was against a positive or a negative list of imports.

Sector Issues

7. The Region justified the policy changes within the natural resource management sector as being designed to prevent the removal of the primary forest by addressing the causes. The proposal was to introduce incentives within the forestry system to encourage conservation through improvements in the logging arrangements such as contracts with logging companies that would encourage the conservation of forest resources; the improvement in land tenure arrangements in forest areas, especially those affecting poor people in local communities; changes in the export tax on forestry products (from volume to value); and better institutional arrangements within the Government to manage these changes. The Region further stressed that the proposed operation has been received well by NGOs working in the field of environmental protection. It also pointed out that there was more support for this kind of operation within the Central African Republic than in other countries of Central Africa. The proposed operation would provide a first initial test for a kind of "affirmative action" by IDA within the environment sector.

8. Policy Content of Operation. The Committee discussed the policy content of the proposed Credit. One member felt that the institution building efforts could be done within the framework of traditional investment operations. This is what the Bank has been traditionally doing for 40 years. He felt that the appropriateness of the quick disbursing component had to be tightly related to a strong policy component in the present operation. The Region argued that the policy changes foreseen for the environmental sector are closely linked to the investment element of the operation, and that this close linkage and the proposed policy changes justify the hybrid instrument. The Chairman noted that the policy issues being taken up in this case would be comprehensive enough to justify the quick disbursing component.

9. The Forestry Fund. With respect to the budget process and the proposal to set up a Forestry Fund, the Region explained that the budget process was still weak in CAR. Although the Region's preferred position was not to earmark funds, it was felt that the three year arrangement was an appropriate response to the CAR situation. The meeting accepted this position, since the environment sector was considered an important part of the priorities of the Government and it was essential to protect the resource allocation for the sector in order to achieve the sector objectives.

Decision

10. The Chairman concluded that the proposed operation involved comprehensive policy changes in the environmental field which went beyond the scope of a usual investment project, justifying a hybrid operation. But in addition to requiring that conditionalities for the release of quick disbursing funds and investment financing be strongly

related to environmental and organizational objectives, he stressed that the disbursement of quick disbursing funds should also be linked to satisfactory macro-economic performance. He also said that while the disbursement of the quick disbursing element for IDA contribution could be made against a positive list as proposed in the operation, the SPA contribution could be disbursed against a negative or positive list but left this issue at the Region's discretion during negotation with co-financiers. The proposed Initiating Memorandum was approved and the Region was authorized to appraise the project subject to these observations.

GS
GSicat:sb

June 22, 1989

Qureshi
E1241

8 80613013 1.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 13, 1989

TO: Operations Committee

FROM: Enzo Grilli, Acting Director, EAS

EXTENSION: 78061

SUBJECT: CENTRAL AFRICAN REPUBLIC - Natural Resource Mangement Project; Initiating Memorandum; Agenda

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1. The Operations Committee will meet on **Friday, June 16, 1989, at 11:00 a. m. in Room E1243** to discuss the Central African Republic Natural Resource Management Project Initiating Memorandum. The following is suggested as an agenda for the meeting:

Macro-economic Adjustment

2. CAR is a landlocked country with a per capita GNP of US $330 (1987). It is mainly dependent on agriculture, including livestock and forestry. Since 1985, the CAR Government has been undertaking a structural adjustment program supported by two SALs. The main elements of this adjustment program are: promotion of agricultural growth, improvement of the private sector through price and trade regime liberalization, retrenchment of the public expenditure, strengthening of public sector resource managment and public investments in support of productive investments.

3. The performance under the current SAL II is described in para. 1.7 of the Initiating Memorandum and in Annex 2 (status of the second tranche release conditions). The Committee may want to ask the Region to review the performance under the structural adjustment program and to analyze the reasons for any shortfalls under the tranche release conditions.

Justification for Hybrid Element

4. The proposed operation includes a quick disbursing Credit component of US $10 million, in addition to the sector and project Credit component of US $21 million. In its transmittal memorandum, the Region stresses the need to ensure a steady cash flow in support of the external financing requirements of the country. Since meeting a country's financing gap is not sufficient justification to design a quick disbursing Credit, the Committee may want to ask the Region what specific policy justifications there are for providing a quick disbursing component for this particular sector operation.

5. Policy Guidance When Quick Disbursing Element is 100% Non-IDA Source. The quick disbursing element in this proposed Credit is largely being drawn from co-financing from other donors. The Region proposes that IDA finance US $2 million, with the rest to be generated from SPA co-financing. The Region is seeking guidance from the Committee for its

views in the case of hybrid lending operations wherein the quick disbursing element is entirely co-financed from sources other than IDA. In particular, the Region asks the Committee: Is the resulting operation considered a hybrid for IDA purposes? What role would IDA play in triggering tranche releases?

6. Disbursement Procedure. The quick disbursing element is to be disbursed against a positive list for the IDA part and the Credit originating from SPA part against a negative list. The Committee may wish to discuss the merits of slicing components of a quick disbursing Credit in accordance with specific disbursement procedures.

Natural Resource Sector issues

7. The proposed operation is designed to support the CAR's forestry and wildlife sector with: institution building, pre-investment activities (inventory of forestry resources and agro-sicio-economic surveys) and projects related to the agro- forestry and wildlife protection. A large part of the operation is connected with the reorganization and strengthening of the budgeting of the ministry in charge of waters, forestry, hunting, fisheries and tourism (MEFCPT), which is the agency charged with implementing the natural resource managment aspects of the Government program.

8. The Committee may wish to ask the Region to elaborate on the institutional and policy reforms relating to the sector's development and to the protection of forests and wildlife. Specifically, the Committee may wish to ask the Region to discuss the tax restructuring within the sector and the relation of this to the promotion of domestic forestry industry. The Committee may further ask about the institutional capacity of the Government to implement the forestry code, given the inability of previous efforts. What could be the realistic expectations?

9. Issue of Special Fund. The Committee may further ask the Region to discuss the rationale for the Forestry Fund as a special fund. As designed, the Forestry Fund will have a life of three years unless renewed with the agreement of IDA. Why should IDA be put into a position of being a special arbiter for a special fund? Does this not weaken the Government budgeting process?

cc: Messrs./Mmes Qureshi, Shihata, Rajagopalan, Fischer, Wood, Jaycox, Karaosmanoglu, Thalwitz, Husain, Vergin, Serageldin, Lee, Shakow, Holsen, Rao, Burmester/Thahane, Cleaver, Steer, Baudon, Girardot-Berg

For Information Only

cc: Messrs./Mmes Hopper, Frank, Parmar, Goldberg, Bock, Pfeffermann, Baneth, Kavalsky, Haug, Tanaka, Robless/Lawrence, Agarwala

GS

GSicat:sb

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

PGO 60010 !

DATE: June 5, 1989

TO: Mr. Moeen A. Qureshi, SVPOP

THROUGH: Edward V.K. Jaycox, Vice President, AFR

FROM: Ismail Serageldin, Director, AF1

EXTENSION: 34502

6/5

Ask Fisher
Is Moeen OK?
Ask Shihata?

SUBJECT: CENTRAL AFRICAN REPUBLIC - Initiating Memorandum for a Natural Resource Management Project

1. I enclose herewith for consideration by the Operations Committee the Initiating Memorandum for a proposed US$10 million IDA credit in support of a US$ 31 million hybrid operation in the Central African Republic. Comments received at the working level review meeting have been incorporated in the present version. With this memo, we are seeking approval to appraise the operation.

2. The proposed operation consists of a quick disbursing component (US$ 10 million) in support of policy and institutional reforms in the forestry and wildlife sector and a project component (US$ 21 million) in support of: institution building in the sector; pre-investment activities (forest inventory); and development actions (agro-forestry and wildlife protection sub-projects).

3. The CAR has a macro-economic framework supported by a second-year SAF and the Second Structural Adjustment Credit. An IMF SAF Review mission which recently returned from the CAR, reports that all SAF quantitative benchmarks have been met with the exception of the reduction in external arrears. An IDA SAL 2 review mission is currently in the CAR. CAR performance under SAL 2 is discussed in the Initiating Memorandum (para 1.7) and summarized in a Matrix (Annex 2) based on information provided by our Resident Mission.

4. The decision to design the proposed operation as a hybrid stems from our lending strategy in the CAR which, along with funds from other donors, aims at financing investments and imports as well as providing SPA financing for filling the substantial external financing gap of the country. This SPA financing would be provided in conjunction with periodic SALs, and with several hybrid sectoral operations. These hybrid operations are helpful in providing a less lumpy approach to quick disbursement which is important to ensure the steady cash flow which the country needs. For this reason, it is envisaged that the US$ 10 million quick disbursing component would be financed by a small IDA contribution (US$ 2 million) and by a much larger SPA contribution (US$ 8 million).

5. Disbursements of IDA funds in support of the policy based component would be against a positive list of imports by the forestry, wildlife and related tourism industry. We believe that these sector - related imports will be high enough to absorb the proposed US$2 million. These funds would be released in two tranches of US$ 1 million each. SPA funds would be expected to be disbursed against a negative list. This

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SVPOP

If you are linking for conditionality why can you not relate your sectoral conditionality to projects & your macro to SAL's or SECAL's, Do we need more than one?

way, we expect to use the modest IDA contribution as a trigger mechanism for tranche releases of the larger amount of SPA cofinancing, in support of the country's balance of payments.

6. The linkage of some of the quick disbursing funds to detailed policy reforms in critical sectors, such as natural resource management, is desirable in strengthening the overall economic policy reform effort. Natural resources (land, forests, water, and wildlife) are extremely important to CAR's economy. CAR's tropical forests and wildlife are important assets for the rest of the world as well. A number of key legislative reforms to be undertaken in this program (revision of the Forestry Code), institutional reforms (dissolution of wasteful autonomous agencies) and fiscal measures (Forestry Fund) are essential pre-conditions to the preservation and rational exploitation of CAR's natural resources.

7. Since we face a shortage of IDA funds for the Central African Republic, we had earlier envisaged to have the entire quick disbursing component financed out of SPA funds. This first approach would have raised operational and legal questions concerning IDA's role in monitoring the tranche release conditions. However, as a question of principle for future hybrid operations, the views of the Operations Committee are solicited concerning the desirability of financing the policy based component of hybrid operations totally from cofinancing, and if so what role IDA could play in triggering tranche releases and whether the resulting operation would be considered as a hybrid for IDA purposes.

8. A central issue of the policy based component is the proposal to create a Forestry Fund as an improvement over the existing system. Presently autonomous sectoral agencies collect forestry taxes with no effective control by the Finance Ministry over the use of those tax resources (I.M. paras 2.21 and 2.22). The desirable solution would be to fully merge the forestry taxes with general government receipts and let the National Budget process allocate to the forestry sector an appropriate share of resources. This would be most consistent with the on-going macro-economic policy reform which is trying to progressively eliminate a-priori earmarking of taxes. It is however only a medium term objective since the budgetary process is still weak and cannot be relied upon to ensure that adequate funds are provided for the environmentally important forestry and wildlife sector in the face of urgent competing demands. Indeed, even with a very constrained sectoral wage bill, the Budget has not provided funds to cover operating costs. Our proposal therefore is to deposit an appropriate share of forestry taxes in a Forestry Fund under the control of the Finance Ministry (IM para 3.16). The Fund would be established for a period of three years, while the central budgetary process is being improved through the macro-economic adjustment program and the Economic Management Project (Approved by the Board in December 1988).

9. The financing package for the proposed operation is still incomplete. Besides US$ 8 million of SPA cofinancing for the quick disbursing component, US$ 5.8 million of other donors' assistance would

be required for the project component. The German Ministry of Cooperation has expressed some interest in cofinancing this operation, starting in calendar year 1990. Support from other potential donors is being sought.

Attachment

cl w: K. Cleaver

cc: Messrs/Mmes. Husain (LACVP); Karaosmanoglu (ASIVP); Thalwitz (EMNVP); Rajagopalan (VPPRE); Fischer (VPDEC); Shihata (VPLEG); Wood (VPDEC); Vergin (SVPOP); Lee (COD); Dubey (EAS); Shakow (SPR); Holsen (CEC); Rao (FRS); Burmester/Thahane (SEC); Liebenthal (SPR); Steer (FRS); Baudon (SVPOP); Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Frank (CFP); Parmar (CIO); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); Tanaka (EXC); Robless (OPNMS); Aguirre-Sacasa (EXT); Agarwala (AFRCE); Haug (EXC); Denning, Edstrom, Ohri (AFRVP); O'Brien, Guerard (AFRCE); Wyss, Peberdy, Heimo (AFTDR); Singh, Westebbe (AF1DR); Landell-Mills, Kaps, Alba, de Wulf, Fares (AF1CO); Dailly, Bordes (Bangui); Baah-Dwomoh, Kawabata (AF1AG); Poortman (AF1IE); Soto (AF1IN); Palein (AF1PH); Noel (AF1SD); Christoffersen (AFTEN); Mpoy-Kamulayi (LEG); Khoury (LOAAF); Thumm (EAS); Petit, Rowe (AGRPS); Piddington (ENV); Taplin (IMF).

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June 9, 1989

The World Bank
OPERATIONS COMMITTEE

Confidential

Minutes of Operations Committee to Consider
INDIA - Integrated Watershed Development Project (Hills)

Held on June 9, 1989 in Conference Room E-1243

A. Present

Messrs. M. A. Qureshi (Chairman)
D. Goldberg (LEGVP)
A. Karaosmanoglu (ASIVP)
B.G. Kavalsky (FPR)
M. McGarry (LAC)
V. Rajagopalan (PREVP)
W. Thalwitz (EMNVP)
H. Vergin (OPNSV)

Messrs. B. Alisbah (ASI)
C. Blanchi (EMT)
T. Baudon (OPN)
H.P. Crevier (SEC)
S. El Serafy (EAS)
R. Grimshaw (ASI)
R. Harris (COD)
T. Hassan (LEG)
W.S. Humphrey (ASI)
D. Lee (COD)
G. Mukami (ASI)
G. Reif (SPR)
W. Schwermer (COD)
B. van de Poll (ASI)
M. Wiehen (ASI)
J. Wijnand (ASI)

B. Issues

1. The meeting was called to discuss the Final Executive Project Summary of the proposed India - Integrated Watershed Development Project (Hills). The discussion covered the main issues raised in the COD memorandum of June 6, 1989. It focussed mainly on (a) technological aspects, (b) institutional and organizational arrangements, (c) project composition and disbursements, and (d) cost recovery.

The Discussion

2. The Region introduced the project by describing the new "vegetative" approach to soil and water conservation to be supported by the project. The establishment of Vetiver grass hedges along the contours of arable land would slow soil erosion in the wet season, build up natural terraces, and increase soil moisture retention, groundwater recharge and dry season water flows resulting in increased crop yields and reduced risk - especially in drought prone areas. The Region explained that the main advantage of the hedges, compared with traditional earth bunds, are that they are inexpensive,

easy to establish and maintain, and replicable. The technology has been used successfully for decades, in the West Indies and Fiji, has been introduced on a pilot basis in parts of southern India covering about 30,000 ha of farm land, and has widespread applicability worldwide under a wide range of soil, rainfall and slope conditions.

3. The Chairman identified the main issue as how to implement this technology on the much larger scale envisioned in the project. The Region acknowledged that the organizational and institutional arrangements to cover four project states, with different administrative set-ups and the need to cover both private and public lands, would require considerable attention during appraisal. While for private lands it was felt that farmers would adopt the new technology once its benefits were demonstrated, its introduction on common lands was considered more difficult. Arrangements were proposed for an interactive planning, monitoring and implementation process involving Watershed Planning and Coordination Offices at state and district levels (to be set up under the project), line agencies and village administration. Local and outside NGOs would be used on an experimental basis to facilitate project implementation and women's groups would also be engaged.

4. The Region felt that a flexible and decentralized approach to institutional arrangements was required to suit the needs and circumstances of different project locations. The various line agencies (including the departments of agriculture, soil conservation, forestry and animal husbandry) would have principle implementation responsibility, with lead responsibility assigned to the agency most concerned with land use in a particular area or state. For example, the forestry departments would most likely be the main project implementation agencies in Himachal Pradesh, and Jammu and Kashmir, where most of the project area was state forestland, while in Punjab and Harayana - with almost all land covered by the project in private hands - the agricultural departments were expected to be the principal executing agencies. The Chairman noted that the main project risk was too much diffusion of responsibility, and that a clear focal point which feels it is accountable for implementation in each state was needed. The Region indicated that his would be carefully reviewed during appraisal.

5. The Chairman next asked what the project would disburse against, since this was not discussed in detail in the Final Executive Project Summary. The Region explained that about 50% of project expenditures would be for the establishment of vegetative hedges and other activities related to soil and moisture conservation and silvi-pastural development. Another 30% would be for water harvesting structures, drainage treatments and infrastructure for line departments. Disbursements would be made against expenditures for such items as nursery development, planting material, hedge and forest establishment on public land, and civil works. The Region emphasized that this was a small project in the Indian context because of the low-cost technology involved. The Chairman indicated

his support for small projects with a high development impact, but emphasized the need for a clear definition of what the project funds would be used for and how they would be disbursed.

6. On the issue of cost-recovery the Region indicated that planting material for the hedges should initially be distributed to farmers free of charge. For other inputs such as seedlings for fruit trees and fertilizer, it would be the intention that these be sold to farmers at full cost. On public lands the initial material and establishment costs would need to be borne by the Government.

7. In concluding, the Chairman pointed out the crucial importance of effective extension for the success of the project. He also emphasized the logistical and institutional challenge which the project presented, and highlighted in particular the need for clear and well focussed implementation responsibilities. He asked that the appraisal mission concentrate on these aspects and on a precise definition of the activities and expenditures for which the project funds would be used. Furthermore, the appraisal mission should get a firm handle on the recoverability of project costs from the beneficiaries. He requested that he be provided after the appraisal with a note outlining what has been determined on these points.

WSchwermer/mh
June 23, 1989
PC#2:WS2:MIN:BL6

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

890607006 1.

OFFICE MEMORANDUM

DATE: June 6, 1989

TO: Operations Committee

FROM: Ducksoo Lee, CODDR

EXTENSION: 73348

SUBJECT: INDIA - Proposed Integrated Watershed Development Project (Hills) Agenda

1. The Operations Committee will meet on June 9, at 12:00 noon in Conference Room E-1243 to discuss the above project. The Final Executive Project Summary (FEPS) and covering note on the project have been distributed by the Region.

2. The project represents a new, low cost approach to watershed development and environmental protection. It is intended to slow down and possibly reverse the ecological degradation in the Shivaliks and Karewas hills using a new approach to soil and moisture conservation, and thereby increase agricultural production and farmers' incomes in an area of about 200,000 hectares in four states (Haryana, Punjab, Himachal Pradesh and Jammu-Kashmir).

3. The project would introduce a "vegetative approach" to soil and water conservation (involving the planting of a special type of grass), which the Region considers superior and more cost effective than the approach taken in a number of earlier resource conservation and watershed development projects in India. The Region might explain (a) what the "vegetative approach" is, (b) the track record of this technology, (c) the differences in the various technologies, and (d) the basis of its judgement that the new approach is superior to the ones used so far. The Region might also explain the potential scope of the proposed technology and its limitations.

4. The FEPS indicates that with regard to cost recovery for such items as seed, seedlings and fertilizer, "the project would need to conform to existing practices" while the appraisal mission should try to agree on arrangements for "recovering as much of the costs as is feasible". The Region might elaborate on the design and implementation aspects considered for cost recovery including possible conditionalities. The Committee might provide guidance to the appraisal mission for developing criteria to be used in establishing an appropriate level of cost recovery, and for designing suitable implementation arrangements. Cost recovery.

5. The project would establish Watershed Planning and Coordination Offices at state and district levels, which would deal

mainly with funding, watershed development priorities, and monitoring and evaluation. Implementation would be the responsibility of line management agencies at village and higher administrative levels. The Region might explain how the proposed institutional set-up would be expected to function, and how effective coordination between the various entities would be established. The Committee may examine whether the proposed institutional arrangements would not be too complex for ensuring effective project implementation and sustainability.

6. The FEPS highlights the important role women play in the agricultural sector in the project area, and the need for their active participation in project implementation. The Region might inform the Committee about the views of the beneficiaries, and in particular the women have been taken into consideration in the design of the project; and how it plans to ensure their appropriate involvement in implementation.

Distribution:

Messrs. Qureshi (OPNSV), Husain (LACVP), Jaycox (AFRVP)
Karaosmanoglu (ASIVP), Thalwitz (EMNVP), Rajagopalan (VPPRE)
Shihata (VPLEG), Wood (VPFPR), Vergin (OPNSV)

cc: Messrs. Dubey (EAS), Shakow (SPR), Holsen (CEC), Rao (FRS)
Burmester/Thahane (SEC), Liebenthal (SPRPA)
Steer (FRS), Baudon (OPNSV), Wiehen (ASIVP)
Grimshaw (AST), Humphrey, Wijnand, van de Poll,
Mukami (AS4)

For Information:

cc: Messrs. Hopper (SVPPR), Bock (DFS), Goldberg (LEGOP)
Frank IFC (CFP), Parmar IFC (CIO)
Pfeffermann IFC (CEI), Baneth (IEC), Kavalsky (FRM)
Tanaka (EXC), Robless (OPNSV)
Ms. Haug (EXC)

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

890605024

1

OFFICE MEMORANDUM

DATE: June 2, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

V Dubey

EXTENSION: 78051

SUBJECT: INDIA - Integrated Watershed Development Project (Hills)

An Operations Committee meeting will be held on Friday, June 9 at 12 noon in Room E-1243 to discuss India's Integrated Watershed Development Project paper. The paper is being distributed by the Region. An Agenda will follow shortly.

Operations Committee

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Rajagopalan, Fischer, Shihata, Wood, Vergin

cc: Messrs. Lee, Shakow, Holsen, Rao, Burmester/Thahane, Liebenthal, Steer, Baudon, Hopper, Bock, Goldberg, Frank, Parmar, Pfeffermann, Baneth, Kavalsky, Tanaka, Robless, Ms. Haug, Alisbah, Wiehen, Wijnand, Grimshaw, van de Poll, Mukami, Humphrey.

890 606009

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 5, 1989

TO: The Operations Committee

FROM: Bilsel Alisbah, Director, AS4

EXTN: 73592

SUBJECT: **India-Proposed Integrated Watershed Development Project (Hills)**

A meeting of the Operations Committee has been scheduled for Friday, June 9, 1989 at 12:00 noon in Room E 1243, to discuss the Final Executive Project Summary (FEPS) for the above project.

Attached please find a copy of the FEPS, together with a covering memo from me to Mr. Shahid Javed Burki, Acting for Mr. Attila Karaosmanoglu, dated May 23, 1989. The Agenda of the meeting will be distributed later.

Attachment

Distribution: Messrs. Qureshi (OPNSV), Husain (LACVP), Jaycox (AFRVP), Karaosmanoglu (ASIVP), Thalwitz (EMNVP), Rajagopalan (VPPRE), Fischer (VPDEC), Shihata (VPLEG), Wood (VPFPR) and Vergin (SVPOP)

cc: Messrs. Lee (COD), Dubey (EAS), Shakow (SPR), Holsen (CEC), Rao (FRS), Burmester/Thahane (SEC), Liebenthal (SPRPA), Steer (FRS), Baudon (SVPOP), Hopper (SVPPR), Bock (DFS), Goldberg (VPLEG), Frank (CFP), Parmar (CIO), Pfeffermann (CEI), Baneth (IEC), Kavalsky (FRM), Haug (EXC), Tanaka (EXC), Robless (OPNMS), Aguirre-Sacasa (EXT), Humphrey AS4DR), Grimshaw (ASTAG), Wijnand, van de Poll and Mukami (AS4AG)

Cost Recovery

What shall we be benchmarking against?

Externalities

- Sets up Water Committees at State + Central levels.

- How do these interact with line agencies.

old projects were criticized in the implementation area

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

$1W million

DATE: May 23, 1989

TO: Mr. Shahid Javed Burki, Acting Regional Vice President, Asia Region

10
20%
70%, Bank

FROM: Bilsel Alisbah, Director, Country Department IV

EXTN: 73592

SUBJECT: **INDIA - Proposed Integrated Watershed Development Project (Hills) Final Executive Project Summary**

1. Attached for your review and approval is the Final Executive Summary for the above project.

2. The FEPS (and draft SAR) were reviewed at a departmental meeting held on May 16, 1989. Views of the meeting and written comments of Peer Reviewers have been reflected in the FEPS. Appraisal is scheduled to begin on June 15, 1989.

Attachment

Distribution: cc. Messrs. Qureshi (OPNSV), Karaosmanoglu (ASIVP), Wiehen (ASIVP), Rajagopalan (PREVP), Inakage (COFVP), Yenal (ASIVP), Gouveia (ASIVP), Shihata (LEGVP), Golan (ASTDR), Humphrey (AS4DR), Lee (CODDR), Petit (AGRDR), Ritchie, Blinkhorn (AS4CO), Gopal, Hassan (LEGAS), Wijnand, van de Poll, Mukami, (AS4AG), Grimshaw, Doolette, Banerjee (ASTAG), Partridge (ASTEN), Gibbs, Morgan (ENVOS), Rowe (AGRPS), Baxter, Alexander (AS4NA).

Mesdames. Baneth (IECDR), Davis (ASTEN), Morris (LOAAS).

FINAL EXECUTIVE PROJECT SUMMARY

INDIA - INTEGRATED WATERSHED DEVELOPMENT PROJECT (HILLS)

Executing Agencies: The Watershed Development Council of the Ministry of Agriculture (MOA), the Governments of Haryana, Himachal Pradesh, Jammu and Kashmir and Punjab.

Tentative Financing Plan:

		%
IDA	$ 72.0 M	70
GOI	$ 2.3 M	2
State Govts.	$ 18.0 M	18
Farmers	$ 10.0 M	10
Total	$102.3 M	100

Khus.
Vetiver

Appraisal Date: June 15, 1989

Tentative Board Date: February 1990

1. Background: Environmental degradation and the low level of productivity in the rainfed areas is a serious problem in India. About 75 Mha of rainfed croplands are affected by the irregularity of the monsoons, whereas another 100 Mha of non arable rainfed areas (forest and grassland) have been reduced to wastelands by over exploitation and are no longer able to provide the much needed fuel wood and fodder for the rural poor and their animals. Part of this vast area concerns the Himalayan ecosystem, particularly the Shivalik and Kerawa hills which represent an extremely fragile situation that deserves priority attention, particularly since it is densely populated. The area is highly erodable and with continuing population growth and accompanying depletion of the vegetative cover it has been subject to rapid degradation of the environment and a deteriorating standard of living for the rural population. To improve rainfed farming and restore some of the productive capacity of the degraded non arable lands in the Himalayan foothills, the introduction of land management practices with the aim of maximizing soil and moisture conservation through cost effective, replicable and sustainable technologies is perhaps the only option left.

2. Experience with previous and on going watershed projects: The Bank/IDA supported four projects dealing with resource conservation and watershed management: Drought Prone Area Project (Cr. 526), Kandi Watershed and Area Development Project - (Ln 1897), Pilot Project for Watershed Development in Rain-fed areas (Cr. 1424) and Himalayan Watershed Management Project (Ln. 2295) with a total contribution of US$ 147 million. Recent Bank reviews of rainfed agriculture and watershed development have underlined some of the important problems and lessons from this development work. Most projects have been overly complex and therefore difficult to coordinate and were marked by the absence of land user participation both in treatment planning as well as implementation. Moreover, many of the technologies to be introduced were inappropriate. Particularly, with respect to soil and moisture conservation technology, too much emphasis was given to structural works for controlling and disposing of run-off rather than capturing the maximum amount of moisture in the soil and retaining it as long as possible to support crop and tree growth. A simpler and more focussed project based on cost effective and

replicable vegetative approaches to soil and moisture conservation, combined with full village participation in the design and management will have therefore a better chance to succeed in sustained resource development.

3. Rationale for Bank involvement: The Bank's Assistance Strategy to India is to support policies and investments that will encourage economic growth and social development in a context of macro economic stability.The emphasis is on efficient resource allocation; increased efficiency in the public sector and the appropriate targeting and delivery of support systems to the poor. The project clearly fits within this strategy with the majority of beneficiaries being the rural poor.With the need to stabilize the land resources in the Himalayas, the project would contribute to the introduction and development of more appropriate technologies for this fragile environment and would also assist in bringing about institutional and policy changes.

4. Project Objectives and Description: The project would aim to slow down and possibly reverse the ecological degradation of the Shivaliks and Karewas and thereby improve the production of and income from crops, fodder and fuelwood in an area of about 200,000 ha in the four states (Jammu and Kashmir, Haryana, Punjab and Himachal Pradesh). The following components would support the above objectives: a) introduce vegetative soil and moisture conservation technologies in selected watersheds and some selected land treatments also outside the sub-watersheds; b) construct waterharvesting tanks for limited irrigation and domestic and livestock purposes; c) strengthen line departments of the states implementing the project and develop approaches for interactive planning and management of commonlands d) strengthen MOA to monitor ecological degradation and establish priorities for watershed development; e) establish, both at the state and the district level, watershed planning, monitoring and evaluation capability; f) provide central support for training SMS from participating states in rainfed farming technology; and g) strengthen the Remote Sensing Institute in Punjab for analysis of imagery and photo interpretation and train line department staff in the use of the techniques.

5. Issues and Actions: Main issues of the project addressed during the pre-appraisal process and on which further work is required during appraisal include:

(a) Cost recovery - The states have requested provision of funds in the project for free supply of seed and fertilizer to encourage contour cultivation and vegetative barriers and also provide free tree seedlings for private forests and orchards. GOI and the states are applying varied incentives for land treatments and crop improvement programs. The project would need to conform to existing practices. Full cost recovery will not be feasible e.g.,for investments whose benefits extend beyond the project area such as stream bank protection and gully control of drainage lines and for purposes of promoting vegetative soil and moisture conservation technology on steep slopes. Details of the cost-recovery arrangements would be determined at appraisal, July 1989, with a view to recovering as much of the costs as is feasible.

(b) Project Scope - To ensure that the thrust of the project is not lost, emphasis would be placed in supporting treatments related to soil and water conservation technologies. But, there have been requests to expand the project scope to include funds for seed and ertilizer outlets, increase support for extension activities, and other activities. The appraisal mission would evaluate these additional proposals, but should resist expanding the project into too many components.

(c) Institutional Arrangements - Planning, coordinating implementation and sustained management are difficult and complex issues to deal with in resource development in the watershed context and past Bank experience has been mixed. The role of various line agencies and the villages involved are the most critical to resolve. To deal mainly with funding, watershed development priorities and monitoring and evaluation, establishing the project would set up permanent watershed planning and coordination offices in the states to effect the integration of line department activities in degraded areas. Similar arrangements would be made at district level.Actual project implementation would be carried out as much as possible by the line agencies themselves. Common property resource management problems and possible solutions to improve interaction with beneficiaries are currently under review by an Indian consultancy firm as part of a project preparation study which will be ready by mid June. It is proposed that the appraisal mission review the study and seek government agreement on implementation of its recommendations,if appropriate. Because of the importance of the issue, it is proposed that an institution and management consultant be employed during appraisal to review and advise on organization and management arrangements for the project.

(d) Role of women- Since women play a substantial role in crop and livestock production, including the forestry sub sector (e.g fuelwood and minor forest products collection) it is important that the project strategy, includes a clear role for women in the interactive village planning and implementation process.

6. Benefits and Risks: The project would increase production of grain crops, fruits, animal products and fuelwood which would directly benefit the rural poor living in the watershed areas. The implementation of soil and water conservation activities, range improvement and reforestation on village common lands and forests would provide employment to the local population particularly the landless and therefore improve their incomes. The project interventions would also reduce environmental degradation and reclaim some of the farmlands in the plains which are no longer being used due to inundation.

7. Main risks facing the project include: a) sustained management of common and public lands; b) coordination between and within line departments and participation of beneficiaries in planning and implementation; and c) some technologies in pasture improvement and in vegetative soil and moisture conservation on non-arable lands have to be refined.

8. The reasons for proceeding with the project in the face of these risks, reflect the perceived necessity to come to terms with important problems of natural resource conservation and the conviction that an integrated watershed resource management approach is best suited to treat these complex issues. The project is of a developmental nature where testing of technology and management of common resource would be carried out before expanding into new areas. Safe-guards would be built in the project to minimize these risks.

A TWO YEAR OLD VETIVER GRASS HEDGE CONTROLLING SOIL LOSS AND RUN OFF ON BLACK COTTON SOILS AT SEHORE UNIVERSITY FARM, MADHYA PRADESH, INDIA. NOV. 1988.: K 50 LAT 23°N LON 77° E RAINFALL 800 mm.

Vetiver The Hedge Against EROSION

MASDAR

June 5, 1989

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The World Bank
OPERATIONS COMMITTEE

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WBG ARCHIVES

Minutes of Operations Committee to Consider PPR's Paper "Policies and Issues for Diversification in Asian Agriculture"

Held on June 5, 1989 in Conference Room E-1243

A. Present

Committee	Others
Messrs. M. A. Qureshi (Chairman)	Messrs. S. Barghouti (AGR)
H. Binswanger (LAC)	T. Baudon (OPN)
J. Goldberg (LEGVP)	R. Grimshaw (AST)
A. Karaosmanoglu (ASIVP)	R. Harris (COD)
J. Peberdy (AFR)	F. Kahnert (ASI)
V. Rajagopalan (PREVP)	D. Lee (COD)
W. Thalwitz (EMNVP)	C. Obidegwu (SPR)
H. Vergin (OPNSV)	M. Petit (AGR)
J. Wood (VPFPR)	A. Ray (EAS)
	W. Schwermer (COD)
	O. Yenal (ASI)
	A. Vorkink (LEG)

B. Issues

1. The discussion covered the issues raised in the COD memorandum of May 23, 1989, and focussed mainly on the need to identify specific actions which should be taken by the Bank and the borrowers to develop and adopt suitable diversification strategies and programs.

C. The Discussion

2. PPR introduced the paper with a brief summary of its main conclusions emphasizing the benefits from introducing greater flexibility into farming systems. In particular, the desirability of taking a broader sector-wide approach to agricultural development was highlighted, including processing, marketing, infrastructure, educational and institutional aspects, rather than the commodity-specific, production-oriented approach taken in many agricultural projects to date.

3. The Chairman indicated that he considered the paper to be balanced and sensible, but that it did not give specific answers to the question of what the Bank should do in its operations and in its dialogue with clients

to develop and help implement appropriate diversification strategies. While the paper did a good job of pointing out some of the pitfalls associated with various extreme approaches, such as excessive Government intervention on the one hand or a completely market-oriented approach on the other, it did not give very specific guidance as to what the Bank should now do. He also questioned whether some of the assertions underlying the paper, such as that irrigation systems design in past projects had a deliberate commodity orientation, were in fact correct.

4. The EMENA Region supported the paper's general tenor of moving away from commodity oriented projects to a broader based sector lending strategy. However, with regard to diversification, the Region saw problems in finding the niches where both the appropriate technological packages were available and the suitable pricing and marketing mechanisms could be identified to ensure adequate incentives for producers and private sector entrepreneurs. In this context, the question was raised whether the Bank has the right people to help identify these niches and bridge the marketing and technology gaps.

5. The Asia Region expressed concern that the paper might be misinterpreted. In particular, there should not be the impression that rice production in Asia was the cause for world surpluses of rice or for the decline in world prices. Also, it should be kept in mind that commodity based lending by the Bank has been generally successful and has greatly assisted the "Green Revolution". The need and desirability for diversification would therefore have to be seen in the context of a dynamic environment where circumstances change. While this may now make diversification more appropriate in some countries, crop specific support by the Bank may, nevertheless, also need to be continued. A concern was expressed that the dichotomy presented in the paper between crop-oriented and systems-oriented lending was dangerous and that generalization was not possible, but that the degree and timing of diversification would need to be examined on a country-by-country basis.

6. Other speakers expressed the view that the proposed diversification strategy with its emphasis on policy and inter-sectoral aspects differed little from the general country lending strategy the Bank would normally pursue in its various client countries. It was also noted that major diversification efforts in the past had usually been government-led and crop-specific. Important for diversification was the acquisition of knowledge about technologies and markets from outside the borrowing country, an area in which the Bank could play a catalytic role.

7. In response to the various comments, PPR emphasized that the paper was not an indictment of past practices; rather the question was what to do now after having been successful with past interventions. Agricultural diversification in general and the paper in particular did not introduce major new recommendations for designing appropriate lending strategies, but the paper's main objective was to compile in one document all the important aspects to be considered in developing suitable agricultural diversification programs. The introduction of new technologies was of critical importance for diversification and investment decisions. In addition, it was necessary

to consider the appropriateness of legal and institutional arrangements which may support or hinder diversification efforts. The paper deliberately refrained from providing specific advice on actions to be taken by the Bank because of the diversity of circumstances in the various borrowing countries. It was more designed to bring out the influence which diversification considerations have on sector work, and the complexity of the process. It was furthermore highlighting the need for special skills in such areas as marketing and agro-processing, which the Bank does not now have sufficiently.

8. The Asia Region indicated that one specific area on which the Bank's work should focus was improving the efficiency of water and other resource use. Also, with the increasing demand for water from industrial users and municipalities, an integrated approach to water use planning was required. The Chairman agreed with the need to improve the efficiency of land and water use in countries such as India and Pakistan, but he emphasized that the problems have been known for decades. The issue to be addressed in the context of the paper was to come up with specific actions which should now be taken by the Bank. Appropriate actions were needed particularly in Africa where the Bank had not considered adequately problems of agricultural productivity and technology. It had, in the past, made the simplistic assumption that technologies which were successful in other countries could also be used in Africa without major adaptation. The Bank now needs to be more active in introducing better technologies and know-how for production, processing and marketing. But how should such an effort be mounted? The Africa Region acknowledged that much more needs to be done, but cautioned that the achievements made in such areas as improving the terms of trade for agriculture, should not be minimized.

9. The Chairman concluded that the next step to be taken was to extract from the report specific conclusions and lessons which would be applicable for actions that the Bank and its borrowers should take in designing diversification strategies and programs. Specific recommendations would be particularly helpful in the area of technology, for example on how to improve the efficiency of water usage and systems design. He asked PPR to prepare suitable recommendations and highlight them in the executive summary of the paper, which should then be submitted to the President's Council for information, and circulated more widely.

WSchwermer:mh
June 23, 1989
PC#2:WS2:MIN:BL1

890605010

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 5, 1989

TO: Mr. Moeen A. Qureshi

FROM: Anandarup Ray, Acting Director, EAS

EXTENSION: 78073

SUBJECT: Policies and Issues for Diversification in Asian Agriculture

1. The Operations Committee meets today to discuss this paper. I have the following reservations about the paper:

- economics of rice production. The paper is based on the premise that rice production has become uneconomic in East Asian countries (presumably also in China and India although these countries are not in the study group for some reason). It is suggested/implied that excessive production has resulted from subsidies to outputs and inputs and from subsidized provision of infrastructure specialized to assist rice farmers. These ideas may be correct but it would be useful if they are better demonstrated or illustrated in the paper. In the case of India I have heard of allegations that rice production is discriminated against relative to other crops; that is certainly the case in Burma. It might be helpful if the paper goes through the economics of rice production, comparing domestic prices with border opportunity costs (these differ from fob and cif prices because of the "thinness" of the world market in rice). This will help us understand the merits or demerits of existing government interventions; it will also help us develop a "global" view of how (or whether) the major rice producing/consuming countries can coordinate their policies to bring about a more stable and efficient world market;

Rice is a strategic commodity & has been discriminated

- price stabilization. The paper endorses the idea of stabilizing the price of rice for food security reasons. Yet this is too broad an endorsement. Some basic questions need to be answered first. For example: Have there been price stabilization schemes for rice in all these countries? What forms have such schemes taken? What have been their costs and how much stabilization has been attained? The section on the economic factors in diversification--which is basic to the whole paper--might be made stronger;

A more balanced approach

- relative prices and incentives. What the paper is basically trying to say is that Governments should not send the wrong signals to farmers and consumers. This means that Governments should desist from actions that distort relative output and input prices. It should also base the allocation of public expenditures on economic criteria rather than on preconceived notions of "comparative advantage" or "need." All this can be said more clearly. Two operational issues arise: (a) how much ESW do we spend analyzing and "dialoguing" relative prices and incentives? Do we have adequate knowledge? (b) How can we bring

1) Q larger pallette of packages.
2) Profitability issues will come up.
3) Do Pricing, costing system, cost recovery systems exist.

4.) Staff mix issue —

Attila

Hanson.
Complexity.

Marketing + Agro Processing -

enough leverage on incentive issues through our lending? Our economic and sector work deals superficially and/or infrequently with these types of issues. There is however a good research initiative from the trade division of the PPR which is looking extensively at India's taxation/subsidy policies in agriculture. We need to do such work on other countries as well, using either Research Committee funds or funds from loans/credits;

- "picking winners." The paper advises against attempts by the Government to pick winners, i.e. to have commodity-based projects. It is certainly very desirable to allow producers to receive the right signals and to decide on their own what crops to grow. But it is neither feasible nor desirable to avoid attempts at picking winners since a substantial part of public services in agriculture is commodity-specific, e.g., research and extension. The fact that Governments will inevitably make some wrong forecasts of future profitability does not mean that the commodity-specific projects should be avoided.

cc: Messrs. Baudon, OPNSV; Lee, Schwermer, CODDR; Dubey (o/r).

ARay:vlw

890524003 1.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 23, 1989

TO: Operations Committee

FROM: Ducksoo Lee, CODDR DLee

EXTENSION: 73348

SUBJECT: Policies and Issues for Diversification in Asian Agriculture
Agenda

Current Bank staff are not fully equipped to do the task

1. The Operations Committee will meet on June 5, at 4:30 p.m. to consider the above PPR paper. The paper advocates that greater flexibility should be introduced into farming systems and that the basis of the rural economy should be broadened. It points out that the major challenge to agriculture in East Asia is to sustain rice production while pursuing diversification of agriculture. To achieve this, the paper underlines the need to think of diversification as a process of adjustment rather than the establishment of specific cropping patterns, and it recommends a shift in resources from crop-specific to more general investments in rural and marketing infrastructure and institution building. It is suggested that this new focus would be applicable to other Regions as well as Asia. The main conclusions of the paper can be summarized under the following four headings:

(i) The Need for Diversification

Now that the rice dominant agriculture in several major countries in Asia (Thailand, Indonesia, Malaysia and the Philippines) has brought about food self-sufficiency (wheat in the case of India), and that this successful performance, combined with low world prices, has significantly reduced farmgate prices of rice and farmers' incomes, there is an urgent need for both agricultural diversification and sustaining the improvements in rice productivity.

(ii) Role of Farmers and Private Sector

The strategy for diversification calls for more imaginative and aggressive roles for farmers and private entrepreneurs in producing crops demanded by markets - which may shift over time - and in the processing and marketing of agricultural products, as well as in input marketing for seeds, fertilizer, pesticides, etc.

(iii) Role of Governments

In pursuing diversification goals, the role of governments should be limited to (a) eliminating the policy distortions hampering diversification, such as excessive subsidy for rice, etc., (b) supporting research and extension necessary for diversification, (c) providing infrastructural investments required for diversification, such as rural roads, irrigation, and agricultural marketing facilities, and (d) providing farmers and rural entrepreneurs access to credit facilities necessary for diversification.

(iv) Role of the Bank

To make the Bank more effective in helping borrowers formulate and implement diversification policies and strategies, Bank staff with the necessary expertise should carry out research and analyses to help determine what the Bank and the countries should do to promote diversification activities.

2. The benefits of agricultural diversification are generally recognized by the various country departments, but the importance given to this subject varies. This is to a large extent due to the differing circumstances prevailing in the different countries. The paper proposes a renewed emphasis on agricultural diversification. The Committee may wish to consider:

diversify into what

(a) what specific actions the Bank should take through technical assistance, project design, lending operations, etc., to promote agricultural diversification; and

(b) what actions the borrowers should take to identify potentials for agricultural diversification and to develop action plans to translate these potentials into reality.

3. Diversification would entail enlarging the base of agro- and other rural industries, by (a) expanding know-how in the marketing of agricultural products, broadening education and training programs in rural areas to prepare people for new activities, and (b) promoting investments in infrastructure (communication, roads, storage and market facilities, etc.) and in industries associated with rural labor and raw materials. The Committee may wish to discuss whether inter-sectoral collaboration needs to be strengthened in the Bank to ensure that support for diversification is suitably incorporated in the lending programs and strategies for the various sectors.

4. The paper emphasizes that the Bank needs to develop staff with different technical knowledge, analytical skills and expertise to accommodate a switch from commodity-based project lending to broader sectoral support for a diversification strategy. The Committee might discuss the extent to which the Bank's skill base needs to be adjusted to support diversification strategies, and how such adjustment could be brought about most effectively.

Distribution:

Messrs. Qureshi, OPNSV; Jaycox, AFRVP; Karaosmanoglu, ASIVP; Thalwitz, EMNVP; Husain, LACVP; Wood, FPRVP; Shihata, LEGVP; Rajagopalan, PREVP; Fischer, DECVP; Vergin, OPNSV

Diversification on a national basis is based on specialization in regions

cc: Messrs. Baudon (OPNSV), Dubey (EAS)
Casley, Harris, Srinivasan (COD)

Broader based option package —

Irrigation system for one not designed for others

WSchwermer:mh
PC#2:WS:PPR:BD5

Exclusive Program for food products

Certain irrigation system are suitable only for only 1 to 2 crops.

— Se much more

Shifts from focussing on Commodity based approach to Sector approach

Heightened awareness of the need to diversify — Indiscriminate support

Arguing against too rapid promise

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE May 5, 1989

TO Operations Committee

FROM V. Rajagopalan, VPPRE

EXTENSION 33419

SUBJECT "Policies and Issues in Agricultural Diversification"

Mr. Qureshi has requested that the attached paper on "Policies and Issues in Agricultural Diversification" be discussed during an Operations Committee meeting. An agenda will be distributed and the date will be announced in due course.

Operations Committee

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Shihata, Wood, Vergin

cc: Messrs. Colaço, PREVP; Petit, AGRDR; Le Moigne, AGRPS; Braverman, AGRAP; Barghouti, AGRPS

P-1866

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: March 8, 1989

TO: Mr. Moeen A. Quereshi, OPNSV

FROM: V. Rajagopalan, PREVP

EXTENSION: 33419

SUBJECT: Policies and Issues for Diversification in Asian Agriculture

1. The main purpose of this paper is to assist the Asia Region and several Asian countries in their effort to address salient issues of agricultural diversification, in light of recent achievements in rice production and food self-efficiency. The paper was produced by a joint effort between PPR and the Asia Region, and is intended for agricultural policy makers and Bank staff.

2. The paper represents on-going work at AGR on impact of issues of diversification on lending, especially in irrigation and drainage, crop production, research and extension, input supplies and marketing services. Technical details of these issues have already been presented in a widely distributed PPR working paper "Diversification in Rural Asia". In addition, AGR work includes field research activities in cooperation with the Asia Region and the International Rice Research Institute (IRRI) in Indonesia, Malaysia, Philippines and Thailand. The purpose of this research work is to identify constraints to diversification and to provide emperical guidance on how to increase flexibility of agricultural systems in response to changing technologies and markets in selected situations.

3. The pervasive theme of the paper is the desirability of introducing greater flexibility into farming systems and in broadening the basis of the rural economy in general. The paper purposely avoids a "pick-the-winner" approach to diversification of Asia. It relates the need for flexibility and its cost to the overall investment strategy for agricultural development.

4. The paper was discussed by the PPR management group on January 25, 1989. Several comments were made regarding the links between diversification and food security objectives and the role of the private sector in the diversification process. It was recommended that the paper include some boxes to illustrate diversification efforts and the processes behind them in selected countries. This has been done.

5. Although the subject is motivated by improvement in rice production in Asia, the approach developed by the paper, its analytical framework and main issues it addresses can be applied to other crops that dominate agricultural production systems in

developing countries. In view of this, you may wish to schedule this paper for consideration at an Operations Committee meeting.

cc: Messrs. Hopper, PPRSV; Ingram, PPRSV; Petit, AGRDR; Colaco, PREVP; Le Moigne, AGRPS; Braverman, AGRAP; Shakow, SPRDR; Liebenthal, Obidegwu, SPRPA; Barghouti, AGRPS

890629009 2.

The World Bank
OPERATIONS COMMITTEE

YEMEN ARAB REPUBLIC:
COUNTRY STRATEGY PAPER

Minutes of the Operations Committee Meeting
held on June 5, 1989 in Room E-1243

A. Present

Committee

Messrs. M. Qureshi, Chairman
W. Thalwitz, EMNVP
E. Jaycox, AFRVP
J. Wood, VPFP
H. Vergin, OPNSV
H. Scott, LEGVP
E. Segura, LACVP
F. Colaco, PREVP

Others

Messrs. T. Baudon, OPNSV
S. El Serafy, EAS
Ms. S. Hadler, FRS
P. Hasan, EMNVP
A. Jabre, CEMME
S. Khenissi, EM3CO
G. Reif, SPRPA
G. Sciolli, EM3CO
W. Schwermer, COD
E. Stoutjesdijk, EM3DR

B. Issues

1. The Operations Committee discussed the Yemen Arab Republic Country Strategy Paper which proposed a lending program of $253 million over the four-year period FYs90-93, including $100 million on IBRD terms in FYs92-93. Among the issues raised in the agenda prepared by EAS were (a) the absence of alternative macroeconomic scenarios and hence alternative levels of lending; (b) reconciliation between the objectives of stabilization and diversification; (c) calculation of income per capita levels for IDA eligibility; and (d) lack of a discussion of sectoral issues and scanty treatment of programs of special emphasis.

C. Discussion

2. At the invitation of the Chairman the Region elaborated on the proposals contained in the CSP. It emphasized the limited time span of the oil deposits (some 10-12 years at the current extraction rates), and the weak leverage the Bank has on the country, given the smallness of the lending program and the availability of aid from other sources. Three macroeconomic scenarios had been developed as part of the Green Cover report and would be discussed by a forthcoming mission to be led by the EMENA Chief Economist. The mission would stress the downside risks and would link Bank posture in Yemen to performance and policy change.

3. The Chairman said that he failed to find in the macroeconomic section an analysis of the impact of the policies discussed on the outcome. What would happen if one set of alternative policies was chosen over another? This is especially relevant to the issue of whether IDA should be continued. More on this should be included in the CSP as it would not be advisable to base our strategy on a scenario that might not actually occur. Also it is necessary to apply a uniform approach to our borrowers. He asked if the central scenario approach in the CSP was appropriate as far as IDA lending was concerned. Given the scarcity of IDA resources, why should we strain these resources if no policy response is to be expected? The Region said that the scenario outlined reflected the least the Government ought to do in order to retain a viable economy. A flexible exchange rate was part of this scenario since the oil reserves will not last long. The oil revenues should not be viewed as additional, as they merely compensate for sharp declines in workers' remittances. The fact that oil revenues flow into the Treasury, however, whereas remittances accrue to the private sector, will help the budgetary situation. While the reforms proposed may appear fragmented, they are quite significant if taken together, and there are indications that the government is listening to the advice being given. We should recall that the draft PFP was turned down by the government, however. The one scenario presented is probably quite realistic. The Chairman asked what if the government did not take the measures indicated? What level of lending would the CSP recommend then? A speaker also reiterated that no linkage had been developed between policy and outcome or between policy and the level of lending.

4. A member said that, lending level apart, he failed to see a connection between the array of projects proposed and the brittle macroeconomic framework outlined. The CSP seems to have a sectoral approach without identifying the issues. Besides, a sectoral approach can only follow a clarification of the macroeconomic situation.

5. The Region responded that the development need of YAR lies clearly in diversification of its economic structure. This would be attained through import substitution and, to the extent possible, export promotion also. The strategy rightly emphasizes the training and education of the labor force in view of migrants' return, the majority of whom are unskilled or modestly skilled workers.

6. A member said the Bank has long been involved with YAR, and he failed to see positive macroeconomic returns from this involvement. Agriculture has received a lot of Bank support; did the Region feel that its progress has come up to expectations? The Chairman also asked about an IMF role if any. The Region said that the economy has certainly progressed during the period of Bank association with the YAR, and that the private sector had been allowed to play an important role in productive activities. Though there was no Fund program, the Fund does monitor developments and reports regularly on the YAR.

7. The Chairman then raised the issue of per capita income. The Region responded that a Bank national income expert had initiated the formula used to separate remittances by short term emigrants from those by

longer term ones, but this formula has changed recently. The Region came up now with an estimate of $580 income per capita. The higher figure used by the Fund of $650 would be reduced once the exchange rate has been adjusted. A member retorted that only if the exchange rate was adjusted would the income come down.

8. The Chairman said that his understanding was that under IDA-9 the donors have very little desire to seek to change the effective cut-off levels for IDA eligibility. A member confirmed this, adding that only very limited Bank management discretion in this regard was expected. The Chairman thought that both tactically and strategically we should be looking at the YAR as a case for IDA graduation -- a case that would provide an opportunity to try to establish country creditworthiness for commercial borrowing. In the interim only modest amounts of IDA lending would be justified. A member added that we should remember that the draft PFP had been rejected, which argues against any but modest IDA lending.

9. Another member returned to the absence of alternative scenarios. He said that it was unavoidable that we should base our lending on clearly conditioned alternative macroeconomic scenarios. The low case scenario would capture poor performance with no possible IBRD lending envisaged. It was only good performance with higher IDA lending that would establish creditworthiness for IBRD lending. The Chairman said that if IBRD money is to be proposed, a section should be added explaining why the country is creditworthy, and the steps that should be taken in the transition period to make it such.

10. The Region said that already we have hinted to the government about possible graduation by YAR from IDA after 1991. The government knows that YAR will eventually have to graduate, but the issue needs careful handling. Arab countries' contribution to IDA is at stake, and they would not wish to see the one or two Arab recipients of IDA cut off. The Region also said that creditworthiness for IBRD borrowing appeared to be quite remote. We should not underestimate how feudal the system remained; how fragmented agriculture land is; and how limited the prospects of development are. OED, however, has confirmed ex post rates of return in agriculture of 11%. Beyond trade reform, the issues of development are very long term, perhaps requiring 20-50 years. Yes, a creditworthiness analysis should be made, but the outcome was quite predictable: it would be too risky for the Bank to lend large sums of money to YAR on IBRD terms. The donor community was not coherent, and we cannot use our lending program to produce leverage on others. We feel in fact isolated, and the proposed IDA lending was the minimum consistent with holding the interest of the Arab IDA donors.

11. A speaker asked if there were many countries Bankwide which should not have IDA money and their creditworthiness was dubious for IBRD lending, and the answer was several. The Bank is not obliged to lend on either IBRD or IDA terms.

12. The Chairman then asked if the number of projects in the lending program was too large as the agenda has suggested. If women were not allowed into schools because of the feudal set-up, should we not do

something? Where are the structural changes in the social sectors: population, women in development and education? As it seems we have done enough in agriculture, is not tourism a sector with potential, particularly for the private sector? As to agriculture, should we not focus on the major constraint mentioned at the top of page 4, i.e. water scarcity about which we have a lot of experience? In a downside scenario, our role in development should be defined, with a symbolic IDA lending for a transitional period after which IDA lending would be terminated. Alternatively a better scenario should be outlined, with action taking place on structural adjustment, spelling out clearly action on exchange rates. The Chairman saw no problem with a modest IBRD lending program provided it was for suitable projects. IDA should be confined to the social sectors (WID, education, population) but industry should be left to other sources of assistance. Finally he thought it was time to make an effort with the IMF to get them involved since IDA prospects for YAR are limited. A special effort should also be made with Arab IDA donors in order to apprise them of the situation.

13. The Region said that given YAR's level of underdevelopment they did not recommend cutting the number of projects in the program, as this would also reduce Bank effectiveness. The Chairman left this to Regional management to decide, but thought that an effort should also be made to revive the PFP.

D. Decision

14. In summing up the decisions of the Operations Committee, the Chairman said that this draft of the CSP should be revised before it could be sent to the President. This should await the return of the mission which will discuss the draft Country Economic Memorandum. The concerns of the OC, reflected in these minutes, should be addressed in the new draft.

June 28, 1989

SESerafy/lcu

890525002 1.

No program with the Fund

Conditionalities review

Debt service ratio 45%?

No Alternative scenarios.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 24, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS (V Dubey)

EXTENSION: 78051

SUBJECT: Yemen Arab Republic - Country Strategy Paper - Proposed Agenda

1. The Operations Committee (OC) will meet on ~~Wednesday, May 31,~~ Monday June 5 1989 at ~~3.00 p.m.~~ 9.30 a.m. in Room E-1243 to consider the Country Strategy Paper for the Yemen Arab Republic (YAR). The CSP draft was circulated to you under cover of Mr. Stoutjesdijk's memorandum of April 21. The Committee may wish to take up for discussion the issues identified in this memorandum.

Background

2. After several years of prosperity built on exporting labor services to, and aid received largely from, neighboring oil countries, the economy began to suffer when oil prices declined after 1982 and a program of economic retrenchment was set in motion to curb the fiscal and balance of payments deficits, but this effort, which met with some success in 1983-86, was relaxed in 1987 and 1988 with the advent of oil exports. Inflation, previously moderate, touched a peak of 29% in 1986, the budget deficit reached 22% of GDP in the following year, and the current account deficit 13% of GDP in 1988. The expansion of public expenditure and the appreciation of the Yemen rial, particularly since the beginning of 1987, have weakened the competitiveness of tradeable goods, led to import and consumption expansion, and encouraged capital-intensive investments. Trade restrictions, besides their distortionary impact, have contributed to the price rise, and induced import smuggling which deprives the government of much needed revenue. The overvaluation of the rial has acted as a disincentive to workers' remittances and capital repatriation. YAR, with its new oil "collateral," has been able recently to borrow commercially, thus increasing its medium- and long-term external debt (previously largely contracted on concessional terms) to $2.7 billion by end-1988, equivalent to 45% of GDP with a debt service ratio of 27.5% (IMF, "Recent Economic Developments", April 24, 1989). The CSP projects a GDP growth of less than 2.5% a year in the early 1990s, with low investment ratios and increased private investment while most of the increase in savings coming from the public sector.

Why not Alternative levels of lending related to performance?

- The CSP does not elaborate alternative scenarios for a macroeconomic framework, and hence only one level of lending is proposed. As it would be advisable to relate the size of the program to the pace of policy reform, the Region might be asked to present alternative levels of lending in response to variable levels of reform.

- The IMF numbers for debt and debt service ratio (DSR) appear higher than those in the CSP (see table of key indicators where the DSR is shown incidentally in terms of imports); is there an explanation for the higher Fund numbers?

Fund numbers are higher

$ 10 million Large Country -

Economic Policy has its ups and downs

Oil 10 yrs left.

Hands of the Private Sector.

At the crossroads — Leverage moderate
Unwilling to combine on leverage with

Parvez Hasan - 3 alt scenarios.

Exchange Rate is flexible

Oil — 10-12 years.

Restrictive demand policies.

Oil revenues are used to
diversify the economy.

CEM

oil reserves — Not 1 billion but
650 billion

Restrictive demand policies.

Import Substitution

Exports - Agriculture
Tourist Education

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Committed in $ 500 million

Told them

1991

P-1852

BoP projections

o Are the projections realistic of negligible current account deficits and sufficient capital inflows effectively to balance debt repayments?

o Can specific policies be devised over and above the liberalization reforms in order to give further encouragement to the private sector?

Diversification versus Stabilization

Is it VS ?

3. As the petroleum deposits are limited, diversification of YAR's economy assumes strategic importance. Expanding agriculture, manufacturing and services, and developing non-petroleum exports are essential to finance needed imports and raise YAR's economic performance. The CSP acknowledges the role a flexible exchange rate and trade liberalization can play in encouraging exports and import substitution. It also lays stress on sectoral policies which would induce supply response. While the CSP argues for the necessity of preventing rapid growth of domestic demand during the oil era with the view to curbing consumption and imports and increasing savings (para. 20), it also states (para. 45) that "a strong stabilization effort will be needed, aimed at limiting annual growth of non-oil GDP to less than three per cent."

Fund
Exch Rate
should be used

o As the stabilization period in this connection is set at 1989-91, the Region might elaborate on what exactly it is seeking in pursuing diversification away from petroleum on the one hand while making sure, on the other, that diversification is repressed for the benefit of stabilization.

Inflation 29% last yr
Currency down,
Contain growth but

Income, Workers' Remittances and Oil Revenue

4. The latest (1988) World Bank Atlas shows 1987 population at 8.43 million, growing at 2.5% a year (1980-87), with GNP per capita of $580. YAR's GNP has traditionally been highly affected by the level of remittances by workers who have lived for longer or shorter periods in Saudi Arabia and other Gulf states. More recently oil exploitation became a major source of income. Because of the relevance of the per capita income level to YAR's IDA eligibility, the issue is rather important. The CSP properly directs attention to the transient nature of the oil finds, indicating that these should be properly managed so that a portion of them be invested to yield a stream of true, sustainable, income after the oil (and gas) has been depleted. National income calculations, currently sanctioned by the UN System of National Accounts (SNA), include all net receipts from such exploitation in current income, thus justifying levels of consumption that cannot be sustained. Until the SNA is revised, the oil revenue will have to be shown as income, and this results in overestimating GNP. As to workers' remittances (listed in two lines in the balance of payments Annex B3 as "factor receipts" and "workers' remittances" which aggregated $1,431 million in 1980, declining to $450 million by 1988), the Region includes in GNP only the "factor receipts," i.e. $260 million for 1988 on the assumption that $190 million (shown in line E1a) were remittances from longer term residents abroad and are in the nature of capital transfers. They are shown "above the line," however, only for consistency with IMF and country practice.

o As YAR has the distinction of setting the level of per capita income at which IDA's effective eligibility is cut off, the Committee may wish to consider the appropriateness of treating remittances according to the method set out in the Annex on Sources and Methods following page 15: (a) is the assumption valid that short term emigrants each transfers annually the equivalent of GDP per capita?; (b) what is the relevant number of YAR population for per capita income calculations (the IMF uses a population of 9.5 million in 1988), and (c) in the light of regional explanations of the above, is the proposal appropriate that YAR continue to receive IDA lending from now until 1992 and beyond?

?

The Lending Program

5. The last strategy paper for YAR (in fact a CPP) was reviewed by the OPSC in 1984, but a PFP was considered by the OPC in February 1987. IDA lending to YAR averaged some $34 million a year in the period FY85-88. Lending has been concentrated in infrastructure and agriculture, and to some extent technical assistance and human resource development. For FY89 two credits have been approved, a public administration development credit and an Eastern region agricultural development credit, both aggregating $25.8 million which is all that is proposed for the current year. For the four-year period FY90-93, the CSP proposes IDA lending of $150 million (annual average $37.5 million) and IBRD lending of $100 million in FY92 and FY93 ($50 million a year). The proposed four-year lending program comprises four operations in agriculture; one in manufacturing industry; three in energy of which two on IBRD terms; three in human resource development; and four in infrastructure, including two in water supply.

o While the emphasis on water and energy fits well with development priorities spelled out in the CSP, the Committee may wish to question the rationale of fragmenting the contemplated limited level of lending over so many operations.

o With fewer operations, can the CESW (Annex E) be trimmed down?

o In light of per capita income (para. 4 above), would YAR still be eligible for IDA lending? (The IMF uses a 1988 per capita GNP of $650.)

Programs of Special Emphasis

6. Paras 34-37 address the environment; education; population, health and nutrition; and women in development. Very little is provided by way of information about problems in these areas or their solutions, and the reader is referred to the paragraphs on the lending program where lending operations are said to take care of the issues. The issues themselves need clarification.

(a) On the environment: the management of the hydrocarbon deposits is dealt with properly as an integral part of economic management; hence the omission of petroleum depletion from para. 34 is perhaps understandable. The issues of water resources and desertification are sufficiently important to warrant careful assessment.

- o The Region might shed some light on the water scarcity and desertification problems, indicating whether they would be amenable to medium-term solution. Would technical assistance be useful? And how would such issues be addressed in the context of the proposed lending program?

(b) On poverty: no part of the CSP addresses the distribution of income or land ownership, wage levels, or welfare of the less advantaged sections of the population, though admittedly the scale of the problem can be surmised from the description of YAR development efforts and the social parameters in Annex C (1988 Social Indicators Data Sheet).

(c) On employment: the picture presented is fragmentary with large numbers of males emigrating, and possibly returning in recent years, while the labor force is shown in Annex C as 1.7 million which appears too small in relation to a total population of over 8 million (9.5 million according to the IMF).

- o The Region might clarify the labor participation situation indicating whether any unemployment is open, and if there are conscious policies to reduce it.

(d) On women in development: Annex C shows that females make up 13% of the labor force, with a participation rate of 6%, and this seems to contradict the important role ascribed to them in para. 37. High female participation in the work force would normally be associated with lower fertility, but this does not seem to be the case in YAR where population growth is said to be 3%. Also female enrollment is only 22% in primary schools and 3% in secondary schools.

- o Is the high rate of population growth at all consistent with the social position of women and their "high" participation in the labor force? How does the Region reconcile the very low female enrollment ratios with the active role played by females in the economy?

OC Members:

Messrs. Qureshi, OPNSV; Husain, LACVP; Jaycox, AFRVP; Karaosmanoglu, ASIVP; Thalwitz, EMNVP; Rajagopalan, PREVP; Fischer, DECVP; Shihata, LEGVP; Wood, FPRVP; Vergin, OPNSV.

cc: Messrs. Lee, COD; Shakow, SPR; Holsen, CEC; Rao, FRS; Burmester/ Thahane, SEC; Liebenthal, SPRPA; Steer, FRS; Baudon, OPNSV; Hopper, PPRSV; Bock, DFS; Goldberg, LEGOP; Frank, IFC (CFP); Parmar, IFC (CIO); Pfeffermann, IFC (CEI); Baneth, IEC; Kavalsky, FRW; Ms. Haug, EXC; Tanaka, EXC; Robless, OPNSV; Aguirre-Sacasa, EXT; El Maaroufi, EMNVP; Stoutjesdijk, EM3DR; Hasan, EMNVP; Voyadzis, EM3CO; Wall, EM3DR; Khenissi, EM3CO.

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June 2, 1989

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The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee meeting to consider Policy Paper in Institutional Development held on June 2, 1989 in Room E-1243

A. Present

Committee

Messrs. M.A. Qureshi (Chairman)
A. Karaosmanoglu (ASIVP)
S. Fischer (VPDEC)
I. Shihata (VPLEG)
E. Segura (LACVP)
H. Wyss (AFTDR)
B. Kavalsky (FRM)
A. Bouhaouala (EMTDR)

Others

Messrs. M. Alexander (AFTPS)
D. Bock (DFS)
F. Chaudhri (EAS)
S. Chaudhry (LATHR)
F. Earwaker (SPRPA)
P. Guislain (LEGOP)
M. Hinds (EMTTF)
A. Israel (CECPS)
D. Lee (COD)
J. Nellis (CECPS)
K. Siraj (CODOP)
R. Taylor (EMTTF)

The meeting was called to consider the Institutional Development Policy Brief. The discussion focussed mainly on the scope and usefulness of the proposed exercise.

B. Issues

At the Chairman's request the authors of the Policy Brief explained the background by noting that the proposed paper grew out of a concern that Bank operations, particularly in adjustment, taxed severely the institutional capacity of member countries. It was stated that well functioning institutions, though slow to emerge, were critical contributors to the development process; that while the proposed policy paper would begin with a very wide perspective the intention is for the final product to be considerably more narrow and focussed; that the paper is being produced in close collaboration with the regions, and that the failure to include a representative of the Legal Department on the Working Group steering the paper was an oversight that would shortly be corrected; and, finally, that the net emphasis of the paper would be on the Bank's institutional development policy and practical suggestions for operational improvements.

In further elaborating it was emphasized that the paper would aim at realistic, practical suggestions. It was pointed out that while quite a lot was known about how one should go about institutional development, there is widespread evidence that the Bank has often not sufficiently followed existing principles. The question is why? This leads to a consideration of how the Bank has approached and handles institutional development concerns. (It was stated that review work to date indicates several areas of good quality Bank institutional development work in sectors.)

The Chairman expressed skepticism that an exercise organized in the way suggested in the brief would produce useful results commensurate with the level of resources likely to be absorbed by it. He agreed that institutional development was important, and that the Bank had done a great deal in this area and would continue to do so. But he felt that the scope was excessively wide and that the attempt to narrow the perspective (viz., line 2, para. 6, p. 3) failed to bring the topic down to a manageable size. He wondered if one can usefully ask, in a general manner, how to enhance the capacity of an institution to promote economic development? Or is the shift in development strategies referred to in the section on the Altered Role of the State, welcome though it is, a specifically institutional matter?

The Chairman felt that the paper made too many categorical statements e.g. on the long-term effectiveness of Bank Technical Assistance for institutional development and that it asserted its conclusions before the promised analytical exercise had been undertaken. He suggested that the paper should first assess the Bank's experience and accomplishments in this field, then decide whether it has done well or poorly, and only then recommend changes. He wondered what objective criteria would be used to assess success in this area.

One committee member thought the approach presented in the paper was too broad and argued for a focus on decision-making processes, which would provide the study with a relevant framework. He counselled caution in advocating the abolition of existing institutions (many of which may have been established with Bank and donor support) in the quest for a more streamlined institutional structure. He suggested that the study not be rushed and that the Bank should be extremely careful in proposing institutional changes. He felt that the paper had to look at internal Bank matters in terms of staffing and incentives for the promotion of institutional development.

Another committee member was also of the opinion that the scope of the proposed paper was far too broad (and he welcomed the statement that it would be narrowed). He thought that the authors brief had already decided what is going to be said in the final product (and interpreted several citations to support his point). He thought it unlikely that one could identify general, trans-regional, trans-sectoral institutional development characteristics; these were likely, he said, to be specific to regions, countries or even projects. He too thought the topic was important, but he had "genuine doubts" that the topic could be usefully approached in this overarching, general way and that it would yield results needed for problem solving in the Bank and its borrowers. It would be better to expend analytical resources on a study of conflict resolution, he said. He also took issue with the brief's statement that the Asia region had no "locus" for institutional development work; he took this to be a criticism and said that it was incumbent on the authors of the brief to show that the approach to institutional issues in Asia yielded worse (or better) results than in regions having special ID units. The lack of institutional development unit in Asia reflected his judgement that institutional issues should not be separated from other issues of sector and macro development and that it was not clear what an institutional expert was.

One speaker stated that institutions are specific to regions, countries and cultures. Given this diversity, what can the paper say that is generally applicable? Perhaps there should be more emphasis on a sectoral approach. He thought that more work should be done on reviewing critically and thoroughly the Bank's past actions and accomplishments in the field.

Another speaker supported the idea that the Bank's experience should be critically evaluated. He thought the experience of other donors should also be investigated. Specifically, he asked for more explicit criteria on how to assure sustainability in institutional work; how to make our interventions last.

Another speaker informed the committee that the need was to narrow the policy paper's focus and that was what the Working Group was presently doing. The paper should, he said, concentrate on the institutional aspects of policy/adjustment reform; i.e., the paper should highlight those institutional changes which are necessary to make policy reform "stick." He also wondered if addressing the paper to management and the Board was aiming at the appropriate audience.

The Chairman summarized: the brief as written does not create confidence that we know what it is we want to accomplish in this field. The exercise should rather:

- state what are the current ID priorities and what we should concentrate on;

- indicate where are the weakest institutions;

- state what we can do about them; and

- what should be the benchmarks for measuring improved institutional performance.

The authors responded by saying that while the present version of the brief did indeed downplay somewhat the evaluation of Bank experience, this was still very much in the study and would be given heavy emphasis. The vast and complex nature of the subject was acknowledged, but they stated that the exercise was designed to concretize and sharpen the definitions and the issues. It was also aimed at identifying the commonalities and general pattern in institutional development work at the Bank, particularly in light of the expansion in its scope in recent years. They stressed that the conclusions have not already been formulated, that the brief offered hypotheses and no definitive judgements.

JNellis/FMChaudhri:gs
June 16, 1989

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

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DATE: June 1, 1989

TO: Mr. Moeen A. Qureshi

FROM: Vinod Dubey and Ducksoo Lee

EXTENSION: 78065 and 73348

SUBJECT: **Policy Paper on Institutional Development - Policy Brief**

1. The Operations Committee will meet on June 2, 1989 at 12 noon in Room E-1243 to consider the above paper before its discussion at the President's Council, also in June 1989. The paper and agenda were distributed to the Operations Committee under Mr. Holsen's memorandum dated May 25, 1989.

2. The Policy Brief argues that major institutional weaknesses which exist in less developed countries cause costly delays and missed opportunities. Consequently, a great deal needs to be done to improve the efficiency, cost-effectiveness, adaptability and sustainability of key institutions. The Bank's involvement in institutional development (ID) has evolved from entity-oriented approaches to broader sectoral coverage and attention to systemic issues, and is likely to continue and deepen. The proposed policy paper would review the Bank's ID related operational work, address issues, and recommend changes, in the techniques and approaches used by the Bank. Moreover, the paper would also propose, as necessary, modifications in strategy, policies and operational tools, staffing patterns, and management systems for the consideration of Bank management and the Board.

3. Considerable work has already been done in the Bank on the topic of ID. Besides the WDR 1983 which focussed heavily on this issue and a number of OED and country specific reports and studies, the Bank has published a book on this subject ("Institutional Development: Incentive to Performance," 1987). The proposed policy paper should use, as far as feasible, the findings of the earlier work. Moreover, the paper should also bring out (i) the role of institutional reform in economic development including implications for productivity, enhanced efficiency of resource mobilization/use, (ii) the Bank's role in institutional reform including the nature of the Bank's changing concerns and major policy options in this respect; and (iii) the nature of experience with institutional reforms in specific subsectors or country situations. Presented below are our specific reactions to the issues raised in the Policy Brief, which you may wish to use to amplify the proposed Agenda for the OC meeting, attached to Mr. Holsen's memo.

Objectives of Institutional Development

4. In our view, the starting point for a policy paper on institutional development should be a clear statement of the Bank's objectives in this area. One of the major reasons for the limited success of the Bank's ID efforts has been that there have been no benchmarks

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against which to measure the success or failure of such work. Such benchmarks are needed for improving the quality of preparatory work for ID as well as for appraisal and supervision. The Committee may wish to discuss the need to define suitable objectives and benchmarks for ID work and may provide some guidance in this respect.

Scope of the Policy Paper

5. The Policy Brief has developed a typology of the Bank's ID work by dividing it into four categories: (i) individual project entities, (ii) structures or systems comprising a number of individual entities mostly at sectoral or subsectoral level; (iii) reform of sectorwide functions (e.g., civil service reform, budgeting); and (iv) rules and norms that directly affect development functions (para.11). The Committee may like to discuss if there are other kinds of typologies (e.g., by type of country) that should be developed. While in one place (para. 6) the Policy Brief gives the impression that the proposed focus will be limited to those (broadly defined) institutions responsible for "promoting and regulating economic development"; in another (para. 7), it is stated that despite the difficult nature of the political and cultural factors affecting institutional development, the paper should address those issues as well. Is it realistic to produce a meaningful policy document on such a broad spectrum of issues and still keep it operationally relevant? Are there topics which could be eliminated from the outset as being less important operationally, for example, technical and specialized issues such as patents and property rights (para. 6)?

Country and Sectoral Variability

6. The Policy Brief proposes to produce generally applicable conclusions as against differentiation of those conclusions taking into account country and sectoral differences. Given the changing nature of the role of the state and Bank operations it is perhaps desirable that the Bank address and prioritize certain ID issues at the general level, e.g., public sector employment and civil service reform, private sector regulatory institutions and procedures, and highlight their implications for country-specific institutional development strategies. The question is: should the proposed policy paper address issues at both the general and country levels or should it leave country-specific institutional issues for subsequent elaboration, to the CDs? The Committee may also discuss what items should be taken up at the general level and what should be the priorities?

Improvements in Operational Tools

7. The Policy Brief has sought Committee's guidance on what Bank modalities should be used in addressing the ID issues - whether through free standing TA projects, or through quick disbursing loans/credits or some other methods. We do not think these are mutually exclusive approaches. An evaluation of past experience with these various approaches and instruments would determine their relative effectiveness and if any general conclusions emerge, these should be highlighted in the policy paper. In any case, it is premature to discuss the modalities before the results of the report's analysis are known.

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Staffing Issues

8. The Policy Brief suggests that staff incentives have mitigated against proper attention to ID, which is a long-term process, in form of increased lending commitments, and disbursements in the short-term. It would be more appropriate to discuss ways and means of motivating staff for ID work after we know, from the full policy paper, what the Bank's objectives and priorities should be in the area of ID.

9. Furthermore, the Policy Brief identifies the need to develop an appropriate staff skill mix and to undertake certain organizational changes to strengthen the quality of the Bank's ID work. This covers the role of resident missions in ID and TA supervision, the need for rationalization of the Bank's internal organization for ID work and PPR's role in operational support, training and research and policy work. The Committee may wish to provide some guidance in these areas.

Collaboration and Regional Participation

10. The Policy Brief proposes that working group with representation from each Region would assist PPR in the preparation of the proposed policy paper. In addition, PPR has proposed to use EDI as a vehicle for obtaining inputs of the borrowers on the Bank's ID work. This may not prove adequate. What other methods can be used to obtain inputs from a cross section of Bank borrowers (e.g., selective representation on the working group for the report, regional seminars, country case studies) and other international agencies (e.g., UNDP, USAID) who have experience in ID work?

cc: Messrs. Vergin, Baudon, Robless (OPNSV); Grilli, Levy, Chaudhri (EAS); Harris, Casley, Srinivasan (COD)

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The World Bank/IFC/MIGA
O F F I C E   M E M O R A N D U M

DATE: 2-Jun-1989 09:34am

TO: Moeen A. Qureshi (MOEEN QURESHI)

FROM: David R. Bock, DFS (DAVID BOCK)

EXT.: 72942

SUBJECT: **OC Meeting on Institutional Development Paper**

Moeen,

I would suggest that you keep today's OC meeting on the review of institutional development mercifully brief. The "policy brief" is longer than the full paper should be, and strikes me as another example of misplaced emphasis on detail. The OC does not need 27 page papers to frame an issue for further study -- indeed it cannot function effectively if you allow such elaborated outlines to be brought to the Committee. The worst part is that the "brief" doesn't do what it should, namely clearly set out what the problem is that requires a big review exercise. I would thus focus the discussion today (for no more than 30 minutes) on such questions as: Why is this study needed? What findings and conclusions are expected to result from it? What, in fact, is the operational (as opposed to theoretical or conceptual) problem being examined?

I gather that the PPR types feel that the whole area of ID is too vaguely defined and used imprecisely in a wide variety of contexts. This is not new. ID has always been a motherhood concept. But does it matter? Is there evidence that this fuzziness of concept is leading to wasted resources? Confused clients? Ineffective operations? I suspect not, simply because there are lots of other reasons why things go wrong.

I suggest that you say little yourself today and simply grill -- and encourage others to grill -- Stan and his colleagues. Force them to be clearer and more precise about the problem they are trying to address and what they expect to come out of the study.

A final thought: imagine trying to hold an OC review of the study once it is finished -- 300 pages of generalities about the conceptual confusion surrounding institutional development.

Sorry to be so "Percy-esque" but I hate to see your time wasted by poorly focussed papers at the OC level.

David

Mr. Moeen A. Qureshi E-1241

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

890525022

DATE: May 25, 1989

TO: Distribution

FROM: J. Holsen, CECDR

EXTENSION: 61755

SUBJECT: Institutional Development Policy Paper

I attach the brief for a policy paper on institutional development, scheduled for discussion by the Operations Committee on June 2 at 11:00 a.m. A proposed agenda for the discussion is also enclosed.

Attachments

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THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 23, 1989

TO: Mr. Vinod Dubey

FROM: Stanley Fischer SF

EXTENSION: 33774

SUBJECT: OC Meeting on Institutional Development (June 2)

Attached is a proposed set of issues that might usefully be discussed at the OC meeting.

Attachment/-

cc: Messrs. J. Holsen, J. Linn and R. Liebenthal

We don't have paper

Why is this study needed

What is the operational problem —

Deliberati[illegible]

Institutional.

Domain

OPERATIONS COMMITTEE DISCUSSION OF POLICY BRIEF ON INSTITUTIONAL DEVELOPMENT

Does have institutional study —

Proposed Agenda

Social Development Study

In the discussion of this policy brief, members of the Operations Committee might want to focus on the following issues:

1. Scope of the Exercise. The initial scope of the study is quite wide, on the basis of a broad definition of institutions, and reflecting the recent--and anticipated--expansions of Bank activities in this area. Is the scope right? Which topics should be given high priority in the study?

2. Country and Sectoral Variability. At issue here is the extent to which the paper can produce general conclusions or should rather stress differentiation of these conclusions taking into account country and sectoral differences.

3. Improvements in Operational Tools. What are seen at this point as the most likely changes in operational tools (e.g. lending instruments, technical assistance, conditionality) necessary to improve the Banks's performance in this area?

4. Staff Incentives. What changes in staff incentives (e.g. lending program priorities, annual evaluations, directives) could help the Bank's effectiveness?

5. We don't have benchmarks against which to measure the performance of an ID unit

5. <u>Collaboration and Regional Participation</u>. The production of the paper is guided by a working group with regional representation, and background papers are being prepared by each region. What other measures could be taken to ensure that operational concerns and views, and those of borrowers, are fully reflected in the paper?

CECPS
May 19, 1989

<u>POLICY PAPER ON INSTITUTIONAL DEVELOPMENT</u>

<u>Draft Policy Brief</u>

Public Sector Management and Private
Sector Development Division
Country Economics Department
May 24, 1989

Table of Contents

Policy Paper on Institutional Development

Draft Policy Brief

I. Introduction

A. The Problem

1. It is widely recognized that major institutional weaknesses exist in less developed countries. Though most of these countries possess some well-functioning institutions, they have far too many which do not carry out their officially alloted tasks, or carry them out poorly, at excessively high cost. While these organizations may fulfill their assigned social or political objectives (maintaining employment levels; rewarding political loyalists), all too often this is at the expense of their stipulated development objectives. Their weak and inefficient performance causes costly delays and missed opportunities and adds to countries' net financial burdens. Obviously, a great deal needs to be done to improve the competence, cost-effectiveness, flexibility and sustainability of key institutions in developing countries.

2. During the 1990s, most developing countries will continue to experience major changes as they attempt to open up their economies, reassess the roles to be played by their public and private sectors, and reduce poverty in the face of extreme financial constraints. Many countries in Sub-Saharan Africa and elsewhere will continue to face the consequences of a widespread institutional breakdown. Several socialist countries will be embarking on significant structural changes in the roles hitherto played by the public

sector. The role of institutional development in these changes is both central, but insufficiently understood. The moment is opportune to undertake a comprehensive and critical review of this field.

3. Institutional development has been part of Bank operations since its inception. Power companies, agricultural extension units, ministerial departments, development banks, project management units--the number and range of organizations that has been assisted is very large. Institutional improvements in areas as diverse as public enterprise reform, privatization, economic policy management, or the operation of individual entities are the result of Bank-sponsored programs. The Bank's activities included under this rubric have expanded considerably during the last decade, and the approaches followed have changed markedly with the increase in sectoral coverage and the introduction of adjustment operations. As a result of this expanded experience, the Bank has found that advice on policy reform is meaningless without measures to assure implementation and sustainability. Resources for investments will be wasted without attention to efficient operation and maintenance. The conclusion is that Bank involvement in institutional development matters is likely to continue and deepen.

4. The purposes of the proposed policy paper are to: (a) assess the institutional issues of particular significance for the future; and (b) propose priorities and an action program aimed at increasing the Bank's effectiveness in institutional development. (The Annex presents a draft outline of the policy paper. This policy brief follows the format proposed

for the paper itself.) The paper is expected to recommend changes in the techniques and approaches used by the Bank in its institutional development activities and to propose, as necessary, modifications in strategy, policies and operational tools, staffing patterns, and management systems. The approach will be practical and aimed primarily at operational improvements.

5. The paper will be addressed primarily to management and the Board. However, it will be based on a number of background papers which will be issued separately and should provide guidance and "best practice" information to both borrower and Bank operational staff.

B. Scope

6. "Institutional development" means to create or reinforce the capacities of organizations to attain their assigned objectives, regardless of whether those objectives are social, political or economic in nature. The proposed paper will narrow the focus and concentrate on those institutions generating, allocating and using resources: i.e., those responsible for promoting and regulating economic development. It will address the key question of how to enhance an institution's capacity to attain economic development objectives. The paper will also examine the utility for the Bank to more explicitly analyze the patterns of rules or "compliance procedures" that order economic expectations -- legal, patents and property rights systems, for example -- which are relevant to the paper because they affect the way organizations perform their development functions.

7. Some analysts have labeled as institutional all factors in the development equation that are not strictly economic, thus enfolding into this concept all political and cultural elements. This stretches the notion too far. Nevertheless, institutional success or failure is clearly intermingled with political and cultural factors. The expansion in the scope of Bank activities has forced it to consider, more explicitly than in the past, the impact of the more salient cultural and political dimensions of institutions. For example, it is difficult to design programs of macroeconomic reform without understanding the issues of political commitment and governance: both the willingness of a regime to push for reform and the actual capacity of the state--including its institutional capacity--to undertake those reforms. Political and cultural elements are obviously difficult to treat, partly because their complexity resists quantitative analysis, and partly because of the great variability in their form and impact from country to country. The policy paper will address these issues, recognizing both the need for the Bank to take them into account and the limitations on its ability to influence them.

II. Assessment of Current Bank Activities in Institutional Development

8. This section of the paper will contain a concise overview and assessment of current ID activities at the Bank. The section will: (a) discuss the Bank's objectives and main approaches in ID work, 89 including a critical evaluation of current operations and of ongoing policy and research

work, and stress the main substantive and operational issues and expected future challenges; (b) summarize, where appropriate, the experience of other donors or cases of particularly relevant country experiences; and (c) analyze the main achievements, strengths and weaknesses, highlighting "best practice" in light of current experience. The section will be selective; it will not attempt a comprehensive coverage of all the issues.

A. Evolution and Overview of ID Activities at the Bank

9. When the Bank was primarily concerned with investments in infrastructure, the institutional counterparts were individual agencies in definable, "hard" areas. The approach followed was to strengthen an individual agency by, for example, changing organizational structures, management information systems, personnel management techniques, planning methods, project-related training, etc. As the Bank expanded its activities to poverty-oriented programs in the social sectors, the types of entities and the focus of institutional development changed. First, it became necessary to deal effectively with regional and local agencies, community organizations, and NGOs, in addition to central government agencies. Second, institutional strengthening in the social sectors required techniques to interact effectively with large numbers of people, providing channels for input and feedback, and a perspective more focussed on social behavior and human resource deficiencies than on structures and systems.

10. In the 1980s, adjustment operations involved the Bank much more than before in strengthening systemic capacity to manage policy reform, both at the sectoral and subsectoral levels as well as in the core and central government agencies. It also led to Bank support for ID actions of a previously unthinkable size and nature, such as: reform of public budgeting systems, rationalization of entire public enterprise "sectors," containment of the public sector wage bill and the restructuring of planning and personnel management systems of governments. New sets of institutions--to manage debt, reform public enterprises, handle privatization ventures--have been created; existing institutions--ministries of finance, planning, civil service commissions--have been assisted. Finally, the emerging concern with private sector development requires attention to the reform of those rules and norms which most affect economic incentives; e.g., property rights and legal and regulatory systems.

11. Thus, Bank institutional development activities can be grouped into four categories:

a) creation or strengthening of individual entities (normally those responsible for project implementation);

b) strengthening and restructuring of institutional structures or systems comprising a number of individual entities, mostly at the sectoral or subsectoral levels (e.g., the set of government agencies dealing with trade or agriculture);

c) reform of government or sector-wide functions (e.g., civil service reform, budgeting, debt management); and

d) reform of those rules and norms that directly affect development functions.

12. The broadening of the Bank's concerns complicates ID work, particularly in terms of relations with the borrower. Instead of one interlocutor, the executing agency, most projects now deal with many and different counterparts, and address such complex issues as the interrelationships among agencies or the incentive frameworks. Though the tasks have been revised, the Bank's staffing capabilities have not changed accordingly. In an earlier period the Bank could draw on staff to design projects to assist executing agencies who had worked extensively with, and even in some cases actually run, the type of agencies that were being strengthened. Today the scope of action covers more institutions and issues, and the operations are managed largely by generalists with little prior exposure to ID issues. The paper will also assess the mismatch common to many adjustment operations between the need for fast disbursements and the long-term time frame required for institutional improvements. This raises two problems: either an attempt is made to telescope the ID component into the time period of one (or even several) quick-disbursing operations when the time required for improvements to be effected is much longer, or it is simply

assumed that the institutional work will continue long after the leverage provided by the adjustment operation is spent.

B. Reform of Individual Agencies

13. This section will assess the institutional development efforts undertaken to date by the Bank on individual agencies in particular sectors, mainly in the context of investment projects. (Category (a) in para. 11.) This experience has previously been analyzed and the paper will provide a synthesis and update of those evaluations, broadly following the format summarized in para. 8. It will focus on the differences in approaches to institutional development work among sectors and subsectors and on the reasons for those differences. If the data permit, the section may explore the implications of regional institutional patterns or patterns among groups of countries. However, since institutional problems and proposed solutions vary greatly from sector to sector, it may prove difficult to discern such patterns.

C. Sectoral and Systemic Reforms

14. This section will assess efforts to reform the institutional structures which design and implement government policy and sector-wide functions (categories b) and c) in para. 11), in terms of three institutional concerns. The first is the <u>institutional aspects of macroeconomic policy management</u>: the improvements required in core government agencies--ministries

of finance, plan and public service, central banks (which have mainly been assisted by the IMF), the prime minister's office, the office of the president--if the design and implementation of macroeconomic policies are to improve. This review will focus in particular on those topics that until now have been the institutional components of structural adjustment operations, including public expenditure management, financial sector reforms, public sector wage bill containment, civil service management and incentive systems, debt management, tax administration, etc. In addition, the analysis will deal with such issues as: (a) whether the Bank should put more emphasis on strengthening core policy and management teams (without addressing the general condition of the administrative apparatus); (b) the conditions, if any, under which the Bank should support general administrative reform; (c) changes in the broader institutional framework, such as laws and regulations, that would enhance macroeconomic policy management; and, (d) whether and how the Bank should deal with these larger "macromanagement" themes in non-adjusting countries.

15. A second concern is the <u>institutional dimensions of sectoral policy reform.</u> Increasingly the Bank is helping to create or reinforce apex institutions, or sets of institutions, responsible for managing sectoral policy reform and investment programs. Themes in this section include the differences in institutional solutions, if any, across sectors; the utility of strengthening institutions in one sector in the face of systemic deficiencies; the creation or reinforcement of links between policy management at the macro and sectoral levels; and the appropriate degree of centralization.

16. A third concern is <u>public enterprise management and divestiture</u>. The paper will distill the lessons learned from three recent evaluations and reviews of Bank experience in different aspects of public enterprise reform. Unresolved problems remain: how can one apply approaches used with some success in middle-income countries in least-developed settings (such as performance evaluation schemes requiring accurate and adequate data); what is the appropriate phasing and sequencing of reforms; what is the validity of certain widely used tools, such as performance contracts or holding companies.

III. Emerging Issues in Institutional Development

17. Based on existing knowledge, and a preliminary reading of ongoing analyses, the following have been identified as three central ID for issues for the coming decade.

Issue A. The Altered Role of the State

18. This issue deals with the need to reorient institutions as part of a shift to more market-based development strategies, and a change in primary concern from market failures to bureaucratic failures. The section will analyze both the institutional changes required to move from closed to open economies, and the implications of a different role for the public sector and a corresponding increase in private sector activities. This is not just another call for the down-scaling of the state, but for a reorientation from a

focus on rigid and detailed control to that of monitoring and support coupled with an expansion in competitive markets. This portion of the policy paper is likely to conclude that the increased emphasis on markets and private sector initiatives will require public sector institutions to: (a) change the way they do things (for example, rely more on competition and self-policing than controls); (b) do less of some things (for example, divest non-strategic industrial enterprises); and (c) do more of other things (for example, the enforcement of contracts and protection of property rights). It will also be important to ensure that the Bank does not support entities or specific functions that ought to be eliminated.

19. An important aspect of this issue is the <u>institutional requirements for private sector development</u>. The policy paper will consider, in particular: (a) strengthening the public sector's capacity for managing a supportive policy and regulatory framework for private sector development; (b) streamlining procedures and privatizing enterprises and functions to increase the scope for private activity where that will enhance efficiency; and (c) developing the institutional arrangements that facilitate a constructive dialogue between the public and the private sectors while reducing corruption and collusion. The impact of the less tangible or extra-organizational institutions--legal systems, property rights patterns, patents systems--is particularly important in this regard.

20. A related issue, to be raised though not exhaustively discussed in this section, is the vast topic of <u>decentralization</u>--the transfer of

authority, responsibility and resources to subnational levels of government. Decentralization is relevant when discussing the altered role of the state because it is often seen as the administrative analog to the revived interest in the extension of market forces; i.e., decentralization is to bureaucratic reform as divestiture is to public enterprise reform. Since the topic has many aspects that impinge on almost every point in the proposed paper, it will also be treated in the context of other issues where it is judged particularly salient.

Issue B. Institutional Implications of the Financial Crisis in the Reconstruction and Rehabilitation of Fixed Capital

21. Fixed capital in many LDCs has deteriorated and in some cases disappeared and a major task of reconstruction and replacement -- combined with the installation of effective maintenance programs -- will have to be undertaken in the coming decade. Not only will large additional amounts of financial resources have to be generated, but also the institutions that build and maintain a country's physical plant will have to be improved. This will require improvements in the performance of individual agencies (mainly, but not exclusively public in this instance) so that they can more effectively use the scarce resources available. The Bank's increased emphasis on systemic institutional issues should, therefore, not be allowed to lead to a neglect of its capacity to help improve the performance of individual agencies. Moreover, the Bank's established institutional development methods used in the various sectors may well have to be modified.

22. The argument is likely to be that the Bank has made an uneven use of the existing state of the art for this type of institutional development. The use of best practice approaches to manage, for example, planning, construction and maintenance, has varied according to the levels of ID awareness, qualifications and interests of the different Bank staff. The projected <u>policy implication</u> is that these activities can be substantially improved by a better and more intensive use of technologies and approaches already available. In sum, <u>reconstruction of fixed capital requires a strengthening of traditional organizations in the infrastructure and productive arenas, both in the public and private sectors</u>. The period of reconstruction will require a special program to strengthen operating entities, and a strong political commitment, to be able to make full use of the techniques and approaches already available. The improvement of maintenance operations should be given first priority.

<u>Issue C. Institutional Dimensions of Poverty Reduction</u>

23. Poverty reduction programs are those based on the delivery of goods and services to specially targeted groups of the population. These programs (mainly in agriculture, education, PHN, urban) are "institution intensive;" and past efforts have been among the most trying and the least successful. Managing service delivery to the poor is especially difficult because both clients and service providers tend to be numerous, geographically scattered and poorly educated. Moreover, clients' needs, problems and

based on evidence

perceptions are often poorly understood by program designers. Under these circumstances, local organizations and NGOs in touch with client communities may be the most appropriate institutional solution; precisely the institutions with which the Bank has had least experience. This section will evaluate experiences to date, and propose approaches to improve the effectiveness of these programs.

24. As with the previous section, the argument will be that the Bank has made uneven use of the lessons learned so far in the design and management of poverty reduction programs. The section would review experience with program design and implementation in six major areas: (i) methods to assess clients' demands and preferences, maximizing client participation in identifying their needs; (ii) techniques to target services so that they cost-effectively reach the poor; (iii) strategic planning of poverty reduction programs, especially the introduction of systems which allow feedback and adjustment as well as experiments with new forms of service delivery; (iv) the pros and cons of using different organizational approaches, ranging from government agencies to private institutions or NGOs, and of using top-down versus bottom-up strategies; (v) ways to manage changes in the type of services provided, both geographically and over time, so as to meet the needs of a segmented client market; and (vi) performance incentives for field staff, including both financial and non-financial rewards.

25. <u>One obvious policy implication</u> of this section is likely to be that poverty reduction programs can be substantially improved by a better use

of techniques already available, (always assuming there is genuine borrower and Bank commitment to poverty reduction). Another is that, where significant gaps in knowledge about how to design and implement these programs remain, these gaps narrowed through systematically experiments with alternative delivery system.

IV. The Challenge for the World Bank

26. Following the review of activities and assessment of emerging or actual issues, the policy paper will then address the set of questions that lie at the heart of the exercise: given that the Bank cannot respond to every identifiable institutional need, what should it be doing in ID? How can it be done? How should the Bank organize itself to achieve these objectives?

A. What Should the Bank Do in Institutional Development? Priorities and Scope of Activities

27. First, the policy paper will make recommendations on the kinds and levels of support the Bank should provide to ID. To some extent, decisions about priorities will have to be region or country specific (and one possible conclusion would be to support the recommendation of the Africa Region's public sector management strategy paper, that called for the development of country-specific institutional development strategies). Nevertheless, the Bank will need to determine priorities at a general level as well, particularly if specialized skills are needed. For example, sector wide

public enterprise reform has now become a feature of most SALs; to the point where the absence of this component must be explained in most countries. The policy paper will define other priority areas for the future, which could include, for instance, public expenditure management, civil service reform, banking supervision, private sector regulatory institutions and procedures, etc. In short, the policy paper will serve as a strategic agenda for ID, which will guide the definition of country level approaches. The precise nature of this agenda will be determined by the conclusions of the preceding two sections.

28. One possible operational implication flowing from this analysis is that the Bank should have either (or both) a positive or negative ID list, i.e., a determination of those ID activities it should concentrate on, and/or those which should be de-emphasized. Another implication is that the Bank should improve its ability to analyze the institutional capabilities and changes required successfully to implement policy reforms at both the macro and sector levels, and to develop country or sectoral strategies for institutional reform. Finally, to conserve resources the Bank might experiment with a policy on ID "graduation," stating when success has been achieved or at least determining when diminishing returns sets in on further ID activities in a particular agency or project or even sector.

B. How Should the Bank Undertake Institutional Development?

29. Past methods of promoting ID relied heavily on technical assistance, on the use of special, and unsustainable, external incentives to attract the best local personnel, and on close and high cost external supervision, by Bank staff or consultants. These methods sometimes produced results in the short-run, but seldom have they created the flexible and especially the enduring institutions that are necessary for the achievement of developed status. This key portion of the policy paper will attempt to set out in concrete detail how one measures the impact of ID actions, what new operational tools should be used, which existing tools and techniques should be modified and how, and which might be downplayed and discarded. A main objective of this section will be to recommend new or modified operational tools to achieve the revised ID agenda.

Is this true?

30. This section will also assess whether the Bank has made adequate use of the "state of the art" in institutional development. This is a difficult issue. Few paradigms are widely accepted and there is an even larger gap between practice and academic theorizing than is usual in other sectors. To date, more progress has been made by conceptualizing from operational experience than from approaches derived from academic work. The paper will assess the extent to which readily available techniques and approaches are worthwhile and have been utilized. It will also suggest ways in which the Bank could make a better use of parts of the academic theory arising from the large number of schools of thought in management and

development administration. In addition, organizational and institutional economics have developed concepts and approaches that until now have not had much practical influence but that <u>prima facie</u> merit consideration (e.g., public choice theory). Finally, the links between ID and cultural and political factors are strong, and the paper will assess the extent to which the Bank should include these factors in institutional analysis and, if so, explore the question of how to go about it.

I thought you did not favour research in this area

31. In terms of <u>policy implications</u>, some alternatives which the paper will explore include reducing the number and scope of TA programs to accommodate the real absorptive capacities of countries; relying more heavily on twinning and short-term consultants; relying more on local expertise from other developing countries; spending more time and resources on preparation and supervision of TA; drastically simplifying the objectives of ID programs, etc. Some of these recommendations have been made before several times and the paper will explore why they have been ignored or only partially implemented. More realistic assessments of ID problems and the timing and results of ID operations -- leading to a redesign of policy reforms or investment programs to bring them into line with real, as opposed to imagined, institutional capacity -- is a likely recommendation.

Don't rediscover the wheel

32. Another <u>policy implication</u> deals with the mismatch in the time horizon between investments, policy reform and ID programs. The failure of past and partial reforms (medium-term disbursing TA projects accompanying quick disbursing operations) to resolve this problem is also apparent. Free

standing TA projects failed to provide the leverage needed to support reforms while the leverage of quick disbursing loans is often dissipated long before the ID component is well established. Furthermore, the time horizon and design of TA components in quick disbursing loans may be warped to fit the needs of the project. The final portion of this section will weigh the pros and cons of different operational approaches, including handling all or certain ID activities promoted by the Bank separately from investment and policy reform programs. These ID programs could conceivably even be managed by different staff with more resources than presently devoted to preparation and (in particular) supervision of ID operations who operate under different incentives linked to ID results rather than to the lending program. Leverage could be maintained through linkages with the overall country lending program.

C. How Should the Bank Change to Improve its Institutional Development Capacities?

33. Institutional development activities have quite different characteristics from investment and policy reform programs. The preceding sections are likely to show that the Bank's management of ID activities has remained largely static, encased in the context of investment or adjustment operations. Furthermore, these sections will likely raise doubts as to whether the Bank has the right mix of skills to deal with the broader institutional problems posed by policy reform programs. Questions will also arise about whether the Bank's internal ID management systems, particularly budgeting and staff incentives, hinder or even undermine institutional work.

The possibility exists, therefore, that the Bank's internal management of institutional development programs needs to be modified and improved.

1. Staffing and Incentives

34. The paper will recommend the kinds of ID skills and experience required by the Bank. The aggregate approach to ID typical of adjustment operations should not obscure the need for expertise in key aspects of institutional reform, such as civil service management, tax administration, privatization, or banking supervision. There is limited in-Bank capacity with the kind of experience that could cover these fields. A possibility is that the Bank needs a critical mass of ID expertise. Even assuming that most of the ID activities will continue to be undertaken by consultants but managed by staff, the Bank should have a minimum mass of expertise to advise and train staff and help review the work in the key areas of ID work. In any event staff training in ID issues will likely be a key ingredient in strengthening the Bank's capabilities in this area. In addition, the strategic agenda on ID will identify a limited number of topics on which the Bank should build up a broader basis of expertise capable of contributing directly to the state of the art and to operational work (e.g., the ID aspects of private sector development; methods of institutional analysis and diagnosis, poverty reduction programs and the ID dimensions of critical fiscal issues such as financial management, tax administration and debt management). The proper mix of staff skills is a critical ingredient in this process.

35. The probability is high that these specialists should be grouped with Bank generalists and <u>the role of interdisciplinary teams in ID should be increased</u>. To date, the more successful ID work--for example, with regard to public enterprise reform--has been undertaken by teams composed of economists, business or public administration specialists, political scientists, and technical specialists. Moreover, direct operational experience, combined with a capacity to generalize from it, can sometimes be as valuable as a seemingly relevant educational background. The paper will suggest ways to increase the proportion of ID activities that are undertaken by such interdisciplinary teams.

2. <u>Management Systems</u>

36. The question of inadequate or inappropriate internal incentives for ID work will be examined. If, as is often alleged, project design receives more emphasis than implementation and supervision; if commitments count more heavily than disbursements; if TA design and management is relegated to junior staff or consultants; if, in short, the Bank de facto signals its staff that ID issues have a secondary importance, then the disappointing results should not be surprising. Moreover, even when staff are aware of what needs to be done, they have few incentives to pursue the ID-optimizing course of action because of time pressures of the lending program (combined with the scarcity of specialists to assist them). The projected policy implications is that <u>Bank operational staff should be given more specific incentives to properly design and supervise institutional work</u>.

Staff are often encouraged to review the relevant institutional issues but they are more frequently rewarded for giving priority to lending and policy reform programs. The result is that they may include institutional components in projects only where these might affect approval and disbursement of Bank-financed programs, with less concern about long term sustainability. There are, of course, large variations among departments and divisions.

37. The paper will argue that <u>Bank operational staff would profit from more specific guidelines on how to do ID</u>. The Bank has a number of fairly general statements on the matter, but there is no set of guidelines that deals with ID as it is presently undertaken. A considerable number of documents, mainly emanating from CECPS, have provided general review and guidance in areas such as public enterprise reform and divestiture, civil service reform, public expenditure management, etc. The Bank has been reluctant to develop guidelines that could be construed as recipes in this field where solutions often appear to be highly specific to the country or situation. The policy paper will consider whether more specific guidelines should be prepared, with all the ensuing risks (which might be minimized through staff training). It will also consider ways of making institutional development work a more clearly identifiable "product" in the context of Bank operations.

[illegible] problem guidelines

3. Organizational Arrangements

38. The paper will consider whether the existing organizational arrangements for undertaking ID are adequate, and, if not, will suggest alternatives. One issue is whether the structure of regional management of ID has excessively fragmented expertise and weakened capacity. Another is how to strengthen the potentially important role of resident missions in this field, which requires close and frequent contact with the borrower countries. A more specific possible recommendation is the transfer of more ID and TA supervision responsibilities to at least some of the resident missions. A third issue is the appropriate role of PPR in operational support, training, research and policy work. The assumption is that the present set of structures will remain largely unchanged. Relations with other agencies and donors will also be reviewed in this section.

39. The likely policy conclusion here is that the Bank's organizational set up for ID is uneven and in need of rationalization. Each of the four Regions pursues a different approach. The Africa Region has a public sector management division in the TD; the PSM unit in LAC is part of the Human Resources Division in the TD, while a similar unit in EMENA is part of the Trade and Finance Division. The Asia region does not have any locus of expertise in this area. Similarly, there are a number of staff specialized in aspects of ID that are scattered among the country departments without a clear pattern, according to the interest of the respective managers, although more

specialized staff might be necessary in the CDs. Regional organizational patterns should probably differ, but by as much as at present?

D. Policy Analysis and Research Work Needed in Institutional Development

40. The paper's assessment of current programs and emerging priorities will result in the identification of a policy and research agenda. This can not be specified in advance, but it is reasonable to think that one issue requiring further thought will be that of extra-organizational institutions; their nature, impact and how the Bank can and should take them into account. The paper will contain an independent assessment of current policy and research programs in ID.

V. An Action Program in Institutional Development

41. In this concluding section the recommendations of previous sections will be distilled and synthesized into an ID action program for the Bank. This will cover substantive issues, a research agenda and the way the Bank manages and promotes ID. (Presentation of the action program will end the policy paper. The remaining two sections of the policy brief deal with the mechanics of producing the paper.)

VI. Division of Labor

42. Much material on ID is already available at the Bank, not only at CECPS and the rest of PPR but also in the Regions and OED. A modest amount of new research will be undertaken, principally to incorporate into the analysis the experience of other development agencies and perspectives on institutional work external to the Bank. Internal reviews will also be required, for example, to synthesize OED findings, to distill the lessons of the most recent operational experience, or to provide an updated perspective of the Bank activities with regard to such general topics as the role of the state. Heavy reliance will be made of existing materials; otherwise the exercise becomes unmanageable.

43. The production of the policy paper will require extensive collaboration between representatives of the Operations complex and PPR units. Only a collaborative approach can ensure that the necessary breadth of viewpoints is gathered and that the final product will speak to practical concerns, both in borrowing countries and within the Bank. This collaboration will be structured in the following way: A working group, composed of one representative from each Region, two (outside of CEC) from PPR, and two from CECPS, will guide and orient the process. Regional and non-CEC representatives will marshall the resources of their region or complex and recommend staff to write background papers or otherwise address component issues; they are in effect the co-producers of the final product.

44. EDI seminars are expected to play an important role in testing the ideas, generating feedback from borrower country officials during the paper's production, and in disseminating the results and recommendations of the exercise. Also, to the extent possible, (e.g., as a by product of operational missions) borrower country personnel will be given an opportunity to comment on early drafts.

45. CECPS has official responsibility for managing the task. The division has Bank-wide experience and expertise in the various sub-fields of institutional development. Individual staff members, not necessarily from CECPS, have been assigned the responsibility for the production of background papers, chapters or sections. Regional staff working full time on institutional development will also be directly involved. The component chapters will be based on, or informed, by background papers, to be prepared by staff and external consultants. (A list is available on request).

VII. Proposed Schedule

46. This policy brief is scheduled for discussion at the PC in June, 1989. A progress report containing preliminary findings and conclusions will be available in August. The first full draft of the paper is planned, in principle, for October, with discussions at the OC and PC towards the end of 1989. A Board review of the paper is tentatively scheduled for April 1990.

ANNEX

POLICY PAPER ON INSTITUTIONAL DEVELOPMENT

Draft Outline

I. INTRODUCTION

A. Purposes of Paper

1) to assess emerging institutional themes and issues of particular significance; and
2) to propose, for the Bank, priorities and an action program in institutional development.

B. Definitions

1) institutions as organizations;
2) institutions as less tangible systems of norms and rules.

II. ASSESSMENT OF CURRENT BANK ACTIVITIES IN INSTITUTIONAL DEVELOPMENT

A. Evolution and Overview of Institutional Development Activities at the World Bank

B. Reform of Individual Agencies

C. Sectoral and Systemic Reforms
(structural and sectoral, including public enterprises)

III EMERGING ISSUES IN INSTITUTIONAL DEVELOPMENT

A. The Altered Role of the State: Market-based Development Strategies and Institutional Reorientation (institutional aspects of the redefined public sector role, and private sector development).

B. Institutional Implications of the Financial Crisis in the Reconstruction of Fixed Capital.

C. Institutional Dimensions of Poverty Reduction.

IV THE CHALLENGE FOR THE BANK

A. What Should the Bank do in Institutional Development? Priorities and scope of activities;

B. How Should the Bank Undertake Institutional Development?

1) substantive approaches
2) operational tools, with emphasis on technical assistance

C. What Changes Should the Bank Undergo Internally to Improve its Institutional Development Capacities?

1) staffing and internal incentives
2) management systems
3) organizational arrangements

D. Policy Analysis and Research Work Needed to Promote Institutional Development

V. CONCLUSIONS AND POLICY IMPLICATIONS

A. A World Bank Action Program in Institutonal Development

May 26, 1989

The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee to consider the Chile - Financial Markets Loan held on May 26, 1989 in Conference Room E-1243

A. Present

Committee		Others	
Messrs.	M. A. Qureshi, Chairman	Messrs.	P. Bottelier (LA4)
	P. C. Loh (LACVP)		E. Segura (LACVP)
	I. Shihata (LEGVP)		M. Selowsky (LACVP
	H. Scott (LEGVP)		P. Scherer (LA4TF)
	S. Sandstrom (AFRVP)		A. Fleming (LA4TF)
	P. Hasan (EMNVP)		P. Levy (LA4CO)
	S. J. Burki (ASIVP)		C. Jones-Carroll (LA4CO)
	D. C. Rao (VPFPR)		A. Kapur (LATTF)
	J. Linn (VPDEC)		A. Gelb (CECFP)
	H. Vergin (OPNSV)		V. Dubey (EAS)
			K. Jay (SPRPA)
			K. Mettala (LEGLA)
			K. Siraj (CODOP)
			D. Flannery (DFS)
			T. Baudon (OPNSV)
			S. Burmester (SECGE)

B. Issues

1. The meeting was called on the pre-appraisal package for the Financial Markets Loan to Chile in the amount of $130 million. The discussion focussed on the first issue of the agenda prepared by the Economic Advisory Staff, i.e., the degree to which the country's balance of payments prospects justify the use of fast-disbursing resources, and on a subsequent proposal from the LAC Region to use the resources from the proposed fast-disbursing component as the Bank's contribution to a possible debt reduction operation.

C. The Discussion

Justification of Fast-Disbursing Resources

2. The Region stated that the proposed project's policy-reform-based fast-disbursing component must be seen as a transition vehicle both from SALs to sector investment lending within the mandate of the Country Strategy Paper and from provision of Bank credit lines to domestic capital market development. As such, it would: (i) maintain dialogue on a critical policy area through a

political transition; (ii) manage net Bank disbursements so as to avoid a precipitous decline; and (iii) most importantly, represent a bold policy initiative on the Government's part by redirecting savings in the privatized pension funds toward provision of private sector financing through capital market development rather than to serve as an easy source of Government borrowing. While the originally projected 1990 balance of payments needs have diminished owing to temporarily high copper prices, Chile's urgent requirement for continued debt reduction continues to justify our making available fast-disbursing resources.

3. One member said he considered the proposed operation to be a combination of an investment loan and a loan for debt reduction, a combination wrongly described as a capital markets adjustment loan. He opposed this approach which mixes the normal business of the Bank with temporary and exceptional financial support to alleviate the debt problems of a given country. Each of these different operations should be dealt with separately, he said. The policy reform elements described by the Region appeared not to be sufficiently extensive to qualify the fast disbursing part of the loan as a sectoral adjustment loan. He also suggested that the individual elements of the loan be appraised carefully. For example, the Bank's own proposed loan securitization program had raised serious legal and accounting questions.

4. Several participants noted that Chile does have a medium-term balance of payments problem linked to its sizeable external debt and vulnerability related to export price volatility, but they questioned both the timing of the Bank's intervention to ease this problem and Chile's overall borrowing strategy. The Region stated that balance of payments projections were subject to considerable variation; copper prices had dropped significantly in the last two weeks. Furthermore, the Chilean's management of their debt over the past five years has been exemplary.

5. There was general agreement at the meeting that the restructuring of government and private financing mechanisms must be more explicitly linked to improved investment and domestic savings patterns to give adequate evidence that this is a true adjustment loan. The Region was asked to strengthen this discussion in loan documentation. Acknowledging this, the Region described the country's advanced stage of adjustment and stated that, in the case of Chile, adjustment cannot be thought of in conventional terms since almost all the significant reform areas had already been addressed. The proposed shift in use of pension funds resources from public to private financing was a fundamental one which the Bank should support.

Debt Reduction

6. The Region indicated that, since preparation of this Initiating Memorandum paralleled the evolution of the Brady guidelines in the Bank, the details of Chile's debt strategy are not in the IM. In summary, Chile plans to make use of the $330 million authorization for debt reduction remaining under their latest rescheduling agreement to put together a debt reduction operation supported by the Bank (with $75 million from the proposed Financial Markets Loan), the IMF, possibly Japan, and their own reserves. A straight debt buyback of about $550 million (with a 19 percent rate of return) could be organized quickly and clearly within the terms of an existing frame agreement between Chile and the commercial bank creditors for debt reduction. The major concerns

expressed at the meeting were whether this package was sufficient to affect materially the country's economic situation, and whether it was within the guidelines as they were evolving. Since this could be one of the first Brady programs, it was important to have a clear idea of the impact on the economy.

7. The Region responded that this operation alone would not entirely attenuate the upcoming bulge in debt servicing, but that it was not to be the last debt reduction on the part of the Chileans. The details of their debt strategy would have to be worked out with the Chileans, but if we did not take advantage of this crucial period of Government momentum before the December 1989 elections while the existing debt reduction frame agreement was still in force, we would be unlikely to have an operation for well over a year.

Other Points

8. In response to other points in the agenda, the Region noted that the proposed project had been developed in close cooperation with IFC and PPR. IFC was not prepared to undertake separate leasing operations because it had other priorities in Chile at this time within its exposure limits. The IMF was currently preparing a new Stand-by of SDR75 million to extend over 18 months, and was supportive of a Brady debt reduction program in Chile. The Region could not consider developing a new, separate adjustment operation to support such a program because of time and staff resource constraints.

Decisions

9. The Chairman indicated that a good case could be made for Chile's participation in the Brady plan, but the Bank was still feeling its way in the area of debt reduction and details needed to be worked out by the Bank with the Chileans. He then summarized his decisions as follows:

(i) Project documentation must highlight the fundamental nature of the change in use of pension fund resources, and must clearly link this change with improved domestic savings and investment patterns.

(ii) Project documentation should be more precise about the macroeconomic environment and conditionality of key policies, as well as refer to the IMF's programs.

(iii) The proposed debt reduction program must be described in the context of the country's overall debt strategy and relationship with commercial banks, indicating why such a program at this time is crucial to achieving a significant ("material") improvement for the country.

(iv) Regarding consistency with Bank guidelines, the proposed amount would probably stretch set-asides to their maximum, but the Board's mandate on this was not yet clear. The Chairman would advise in the near future whether the proposed $75 million for a debt buyback was within the mandate. In any case, the Region must make a case for front-loading.

With these caveats, the proposed project was cleared for appraisal.

May 30, 1989

THE WORLD BANK

Operations Committee

CONFIDENTIAL

Minutes of the Operations Committee to Consider
ZAIRE - Energy Sector Credit

Held on Friday, May 26, 1989, in Conference Room E-1243

A. Present

Committee		Others	
Messrs.	M. A. Qureshi, Chairman H. N. Scott, LEGVP A. A. Churchill, PRE K. T. Yurukoglu, FPR S. Sandstrom, AFR P. Hasan, EMN S. J. Burki, ASI E. L. Segura, LAC H. Vergin, OPNSV	Messrs./Mmes	P. Isenman, AF3DR V. Dubey, EAS M. Penalver-Quesada, AF3IE N. M. Gorjestani, AF3CO J.-L. Sarbib, AF3DR F. S. O'Brien, AFRCE W. Schwermer, CODOP W. P. Ofusu-Amaah, LEGAF A. Ceyhan, AF3IE D. P. Hughart, AF3IE P. J. Lazar, AF3CO G. Sicat, EAS C. F. Obidegwu, SPRPA P. J. Dufour, FRM G. Taplin IMF T. Baudon, OPNSV

B. Issues

1. In discussing this Credit, the Operations Committee followed the agenda prepared by EAS.

Government Commitment

2. Responding to the Chairman's query on whether the Government is more credible now in spite of past failures to live up to promises, the Region replied that to put back the macro-economic policies on track, IDA together with other donors sent a message to Zaire that financial aid would be resumed only if the adjustment program were resumed. The Region required that up front actions were substantial and credible. The Government had already undertaken a number of significant measures. The appointment of Mr. Kengo as prime minister had improved the policy dialogue, especially since he had the reputation of being able to stand up to the leadership on the need for sound policies. The Region stressed that this would be the year of close monitoring of program implementation. The Region further stated that the proposed

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Credit operation is a demonstration of the approach that was being followed. As it has two tranches, with de facto sub-tranching, disbursement is closely linked to the Government's observance of the agreed macro-economic program.

The Sector Program

3. The Region stated that the Energy Sector Credit includes a radical change of policies in distribution, pricing and procurement in the energy sector. With respect to prices of petroleum products, pricing adjustments and competition are to be allowed by encouraging entry and promoting deregulation of the downstream level of distribution. With respect to the investment portion of the Credit, the Region said that there were no radical departures from the original energy sector project which was conceived to support the long-term public investment program (PIP), with the exception of the provisions pertaining to the Mobayi project. With respect to the Mobayi project, the Government had conveyed, on May 8, that it would consult with IDA before undertaking any further investments in this project beyond the three turbines that had already been installed. As to electricity tariffs, the Government had undertaken up front actions in increasing tariffs. The objective of the Credit, in this respect, is to make the tariff rates equal to the long run marginal cost of energy. A recent study suggests that marginal cost is twice the average tariff rate.

4. In responding to a question on the strengthening of the fiscal position of the Government, the Region explained that this objective is included in the overall macro-economic program. Revenue enhancement is addressed in the PFP with a package of tax revenues (administrative and turnover taxes). With respect to public expenditure, this was always a sensitive topic in Zaire. The level of public expenditure is not out of line with levels prevailing in other countries in the Africa Region; the problem was in its composition. The level of foreign exchange expenditure was a key monitoring element in the structural adjustment program. It would be held below $200 million in 1989 as compared to a level of $600 million in 1988 when the program was off track.

5. A member observed that if the objective is to remove high rents resulting from oil procurement, a problem which is also prevalent in the other countries of Africa, then ex post control of profits through competitive bidding did not assure the disappearance of these rents. There could be collusion by the companies in the bidding process and hence rents would only be divided. It was further added that the bidding process prevented the country direct access to the spot market for crude. The Region replied that although this was a risk, they had preferred a market solution over one in which the Government decided the procurement directly.

6. Another member also pointed out that the Credit did not address the important issue of strengthening of management of the oil refinery sector. In answer, the Region indicated that they did not include this matter as they had wanted to simplify the project as much as possible. They would, however, consider this suggestion.

Justification of the Quick Disbursing Portion

7. Responding to the question of why $90 million was provided as quick disbursing assistance, the Region stated that this included the spare parts requirements of the energy program. The rest of the amount was to be disbursed against a positive list, consisting of the equivalent of one half of the year's petroleum imports. It is also justified on the basis of the macro-economic program. This led to the discussion of the overall financing of the macro-economic program and the implied burden sharing.

Financing Requirements and Burden Sharing

8. The Region stated that the bottom line PFP financing requirements for 1989, including arrears to be rescheduled, amounted to $1.5 billion. This implied a 20% increase in grant financing. A donor's meeting in April 1989 yielded the conclusion that, assuming that the Government was on track with its structural adjustment program in 1989, these requirements could be fully financed with the expected rescheduling and confirmation of new commitments of $25 million in quick disbursing assistance in addition to the existing commitments. The size of the gap for 1990 and 1991 depended on whether the Fund would come through with an Enhanced Structural Adjustment Facility (ESAF). Overall, net transfers of about $350 million a year are envisaged; however, there is a substantial negative transfer in the case of the IMF. IDA would account for about 55% of net transfers including the IMF, but less than 40% of net transfers of all the donors with positive transfers.

9. The Chairman commented that the anticipated disbursements from IDA were large. Could Zaire develop a track record to deserve this volume of financing? The Region replied that there might be a case for raising the level of disbursements, assuming a credible program. Nevertheless, the level of IDA disbursements assumed in the program is only marginally higher than in 1987 when IDA started adjustment lending to Zaire. It would of course be preferred if the Fund were to come in to fill part of the financial gap. The Region further added that the additional disbursements are mostly from quick disbursing operations, since the investment projects are in accordance with the projected pipeline. The Region stated that it had an understanding with the Fund's Africa Department that IDA would be prepared to do its share of the financing only if there were a substantial effort by the IMF in the context of an ESAF.

10. The Chairman invited the Fund representative to present the Fund views on the financing requirements. The Fund representative confirmed the projections in the PFP, but added that it was not the Fund's practice to project its financing. He cautioned that in the case of Zaire, Fund assistance would likely be in the vehicle of a SAF rather than an ESAF. The latter required a country to meet tighter criteria. He doubted that Zaire could meet the payment of all due interest by 1994. However, given the difficult outlook for the medium term, he said that with good performance by Zaire on its macro-economic program, the Fund support in the order of $150 million would be manageable.

Tranching and Disbursement

11. One member felt that the level of the quick disbursing element represented a substantial up front commitment by IDA. He did not see the liberalization in the sector as being related to the tranching. The Region replied that the amount involved may be large but it should be related to the large size of the country. Reacting to the Region's proposal to release disbursement within a tranche in accordance with petroleum tanker load arrivals which were usually on a monthly basis so long as the country were up to satisfactory performance, one member suggested that the procedure was too cumbersome and may absorb excessive staff resources. The Region responded that this procedure was designed only because of the specific client and its low credibility. The Region further added that it had made it clear to the Government that IDA was not ready to undertake disbursements in large amounts because of previous experience. The Chairman observed that the procedure is being suggested in order to keep the country on a tight leash while testing its capacity to live up to the program agreements. He further noted that the liberalization of the petroleum sector is the conduit through which the macro-economic program is controlled.

Environmental Issues

12. In response to the query of the Chairman about environmental and riparian issues that may be related to this proposed Credit, the Region replied that they have prepared an environmental issues paper for Zaire and that there were no riparian issues related to the Credit.

Decision

13. The Chairman concluded the meeting by stating that the Initiating Memorandum was approved as proposed by the Region.

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June 2, 1989

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 22, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

V Dubey

EXTENSION: 78051

SUBJECT: ZAIRE - Energy Sector Credit Initiating Memorandum; Agenda

158 million

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1. The Operations Committee will meet on **Friday, May 26, 1989, at 3:00 p. m. in Room E1243** to discuss the proposed Zaire Energy Sector Credit containing quick disbursing elements. The Committee may wish to discuss the issues identified below:

Background

2. Recent Macro-economic Framework and Government Commitment. A structural adjustment program was undertaken by Zaire with the assistance of a structural adjustment credit in 1987. The first tranche of this Credit was disbursed in January 1988, four months after effectiveness. Throughout most of 1988, Zaire's adjustment program was off track. Imprudent extra budgetary public spending, poor spending priorities and delayed reforms in accordance with the structural adjustment program led IDA to withhold the SAL second tranche release originally set for March 1988. Since the reappointment of Mr. Kengo as Prime Minister in late 1988, the policy dialogue with Zaire has been placed back on track with the Government taking actions on policies required to meet second tranche conditions for the SAL, including the conclusion of the Second-year PFP.

3. The Committee may wish to ask the Region to comment on the commitment and credibility of the Government to pursue the structural adjustment program given the past experience with it. To what extent is the present state of the dialogue dependent on the tenuous position of the Prime Minister staying in office? What steps are being taken to assure that this committment is adequately tested in the context of the current policy dialogue?

Rationale for the Hybrid Credit Element

4. The energy credit was initially appraised under procedures for investment projects. The original amounts for the quick disbursing components have risen to US $90 million under the present draft Initiating Memorandum. Most of the quick disbursing component is to finance half a year's country requirements of petroleum imports. The Committee may wish to be informed of the incremental changes in this credit operation, specifically the policy content of the proposed operation which justifies its need for a quick disbursing component.

Energy Sector Framework

5. The IDA strategy in the energy sector is designed to promote reforms to liberalize pricing and marketing, to ensure least cost supply of energy and to strengthen key institutions.

6. Electricity Tariffs. The objective of electricity pricing reforms is to provide cost recovery and to adjust for domestic inflation and currency exchange rate changes. The Committee may wish to be informed on the steps being taken to assure that electricity tariffs are adjusted according to these principles over time and not only in connection with current operational objectives.

7. Petroleum Products Marketing. The proposed operation aims to remove the price fixing powers of the Government, to allow for greater transparency in import procurement and to allow greater freedom among major marketing companies to set prices. Since the companies marketing petroleum products are either fully Government-owned (PetroZaire) or semi-public companies, the influence of the Government to set prices is still large. The Committee may wish to ask the Region to elaborate on the issue of how the proposed operation would enhance cost recovery for petroleum products especially in the context of the Government petroleum company and other agencies, the maintenance of adequate supply and the efficiency of distribution petroleum products throughout the country.

8. The Region may also further elaborate if there are any implications related to the strengthening of Government revenues (additional reform of petroleum taxation) and of budgetary resources (settling cross-arrears among Government agencies in the energy sector and collection issues) which require further attention?

9. Efficiency of Energy Investment. With regard to the issue of least cost investment, the Committee may wish to be apprised by the Region of the steps taken to assure that the investment projects in energy constitute the most efficient use of investment resources. The Region may further elaborate on the implications of the Mobayi Project on the rate of return of investments in energy generation and on what steps are being planned to assure that high cost and uneconomic power projects are not pursued.

10. Institutional Strengthening. The Committee may wish to ask the Region to elaborate on how the operation will contribute to the institutional strengthening within the energy sector.

Financial Sustainability of Macro-economic Framework and Adequacy of Burden Sharing

11. To make Zaire's external financing requirements feasible under under the macro-economic adjustment program, debt rescheduling and reduction are required. Although the benefits through the Paris Club and Toronto concessions are projected, the financing gap remains large. The sources of foreign exchange earnings are too dependent on copper earnings which are volatile, and on other sources of export earnings and import saving prospects which are fairly limited. The Committee may wish to ask the Region to elaborate on the financial sustainability of

the program. In particular, is the IDA taking on too large a proportion of the financing burden for Zaire's requirements? Can the Region spell out the burden sharing planned for other donors? Are Zaire's investment projects in the context of the proposed energy project being financed with sufficient concessionality from other other sources?

Tranching and Disbursement

12. The proposed quick disbursing component is to be disbursed against a positive list. The draft Initiating Memorandum proposes to disburse the amount of the petroleum facility of $75 million in two tranches, leaving a balance of US $15 million to be disbursed against spare parts of the Government petroleum company unspecified as tranching. The Committee may wish to ask the Region to address the issue of whether, given the track record of the macro-economic program, it would be advisable to have more than two tranches? The Region may also further explain the procedure contemplated in setting monthly disbursements subject to prior approval of IDA within specific tranches. Are these requirements not adding undue burden on IDA's monitoring capacity, and in effect, also equivalent to multiple tranches?

Future Operations and Need for a Strategy

13. The resumption of the macro-economic program with Zaire has led to an upsurge of operations that were delayed in their implementation and which may now be speeded up to meet the financing requirements of the adjustment program. The Committee may wish to ask the Region what new operations are immediately in the pipeline and what financing resource requirements from the IDA are planned? In particular, the Committee may wish to pose the question as to whether it would be desirable that a country strategy paper be prepared to consider these new operations in light of the changed conditions in the policy dialogue with Zaire or in conjunction with any proposed future operation?

Environmental and Other Issues of Special Concern

14. The Committee may wish to ask the Region to elaborate on the environmental implications of the investment program -- both for generation and for transmission. The Committee may wish to be informed as to whether there are any riparian issues affecting third countries and groups of people within the country which threaten the investment dimensions of the energy project?

cc: Messrs. Qureshi, Shihata, Rajagopalan, Fischer, Wood, Jaycox, Karaosmanoglu, Thalwitz, Husain, Vergin, Isenman, Lee, Shakow, Holsen, Rao, Burmester/Thahane, Penalver-Quesada, Steer, Baudon, Hughart

For Information Only

cc: Messrs./Mmes Hopper, Frank, Parmar, Goldberg, Bock, Pfeffermann, Baneth, Kavalsky, Haug, Fardi, Tanaka, Robless, Agarwala

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Qureshi
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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 8, 1989

TO: Mr. Moeen Qureshi, Senior Vice President, Operations

FROM: Edward V. K. Jaycox, Vice President, Africa

EXTENSION: 34000

SUBJECT: ZAIRE - Structural Adjustment Credits (Cr-1831-ZAR, SFA and SJF A-30-ZR): Proposed Release of Second Tranche
- Approval of Second-year Policy Framework Paper, and
- Energy Sector Credit - Initiating Memorandum

Introduction

1. This memorandum summarizes actions the Government took under the structural adjustment program, and, on that basis, recommends the release of the second tranche ($82.5 million) of the Credits which were approved in June 1987 and became effective in September 1987. In addition, this memorandum seeks your final clearance of the attached second-year PFP before it is distributed for consideration by the Committee of the Whole. Finally, I am requesting the Operations Committee to approve the attached Initiating Memorandum for an Energy Sector Credit to Zaïre. The Energy Sector Credit has already been appraised (before the recent guidelines on hybrid operations) but we propose to include policy conditionality on liberalization of the petroleum sector and to increase the size of the quick-disbursing component.

2. I understand that the earliest available date for an Operations Committee meeting would be May 26. This date would be fine for the Energy Sector Credit which we could appraise in June. However, the tranche release and the approval of the PFP, which must precede the tranche release, should take place by mid-May if we want to keep up the momentum of the reform program and to ensure that availability of foreign exchange to the private sector continues at satisfactory levels. I therefore ask that, in the event you or another OC member requests a meeting on the PFP, the date of the meeting be set no later than May 15. If the PFP is approved on a no-objection basis by the OC and you approve the tranche release, the PFP and the announcement of tranche release, a draft of which is also attached to this memorandum, will provide the necessary macroeconomic setting for the OC discussion of the Energy Sector Credit Initiating Memorandum on May 26.

Background

3. The first structural adjustment credit (SAL) to Zaïre supports a program designed to address the major structural constraints in the economy, lay the basis for sustained growth and improve the balance of payments position over the medium term. The program includes: (i) measures to strengthen macroeconomic management - public investment and expenditure programming and execution, and fiscal, financial sector, civil service and public enterprise reforms; (ii) improved sector policy framework for agriculture and transport infrastructure; and (iii)

measures to strengthen the incentive framework for private sector investment. The first tranche of the Credits ($82.5 million) was entirely disbursed by January 1988, four months after effectiveness.

4. During most of 1988, Zaire's adjustment program was off-track due primarily to excessive extra-budgetary expenditures which financed mostly non-developmental activities. We responded by withholding the release of the SAL's second tranche (originally scheduled for March 1988) and processing of the proposed Energy Sector Credit, and suspended disbursement on the Sixth Highway Project and two lines of credit to SOFIDE, a development finance company. We also convinced other donors, except the African Development Bank, to withhold quick-disbursing assistance under the SPA. At the same time, we continued an intensive dialogue to help the authorities put the program back on track. In late 1988, President Mobutu appointed Mr. Kengo, the decisive manager of the 1983-86 reforms, as Prime Minister. We took this as a sign that President Mobutu was prepared to implement the delayed reforms. But we told the authorities that, before releasing the second tranche, we would expect: (i) substantial up-front action on the outstanding issues, notably petroleum pricing and uneconomic projects in the Public Investment Program (PIP); (ii) compliance with all formal conditions of tranche release, including an agreed macro-framework; and (iii) personal assurances from President Mobutu on budget discipline. By end-February 1989, Mr. Kengo had succeeded in implementing nearly all of the key outstanding policy measures. A Bank/IMF joint mission also reached agreement at the technical level on the main policy issues of the second-year PFP, which had been cleared by the Operations Committee in May 1988.

5. I visited President Mobutu on March 17 and obtained his commitment (a necessary if clearly not sufficient condition for success) on three key points: (i) keep public expenditure within agreed budgetary limits, and respect the agreed PIP; (ii) reduce substantially government foreign exchange expenditure (from about $550 million in 1988 to $180 million in 1989 net of debt service and project/military assistance programs); and (iii) agree to close monitoring of expenditures by Bank/IMF including monthly reporting and formal quarterly reviews. I have a clear understanding with President Mobutu that the Bank would stop disbursements under quick-disbursing operations if Zaire does not respect these agreements.

6. A Zaïrean delegation led by Mr. Pay-Pay, Governor of the Central Bank, visited Washington April 3-11 to finalize the PFP, the Letter of Intent for a stand-by arrangement and a second year SAF, and discuss the timing of the release of the SAL's second tranche. The Zaïrean delegation described the progress achieved so far in implementing the adjustment program, and provided the Bank with the documentation related to the specific measures which are conditions of tranche release. A special donor meeting was held on April 5 under the Special Program of Assistance to confirm financing of the three-year program under the PFP.

7. The Fund management has approved in principle the financial program under the stand-by and the Second SAF. The text of the PFP is

completing the final clearance process in the IMF. We expect to present the PFP for consideration by the Committee of the Whole in the second half of May. The IMF Board is expected to consider the second SAF and a stand-by in late May/early June. President Mobutu is expected to sign the PFP and the Letter of Intent by May 10, after Zaïre has cleared about SDR 100 million of arrears to the IMF financed by a bridge loan from a syndicate of commercial banks. Mr. Touré, Director of the IMF's African Department, has visited President Mobutu on April 26 to impress on him the importance that the Fund also attaches to strict implementation of the agreements concluded. In view of the substantial progress made in the last four months in implementing the key measures under the program and given the urgent need to provide foreign exchange to the private sector, the Governor asked IDA for a quick release of the second tranche in line with the understanding I had reached with President Mobutu during my visit. We recognize that Zaïre's credibility is low and the program is risky. However, considering the measures they have taken and President Mobutu's personal commitment, we ought to give the program a chance, while monitoring and controlling it more tightly than usual.

<u>General Progress</u>

8. After delays and backsliding in program implementation during most of 1988, progress towards improved management of the economy has been impressive since December 1988. Specifically, the Government:

- adopted a comprehensive package of revenue measures, including new fuel taxes; doubling excise taxes on alcohol and tobacco and administrative fees and charges; and increasing by 50 percent the turnover tax and the minimum import duty;

- introduced new stringent expenditure control procedures; the execution of the budget is linked to monthly Treasury plans so budgeted expenditures are authorized only up to the amount of actual revenue collected; the Prime Minister oversees the process to ensure adherence to the budget targets;

- agreed on a drastic reduction of its foreign exchange expenditures in 1989;

- doubled petroleum product prices and most transport fares;

- increased the inter-bank interest rate from 35 to 60 percent and agreed to further increases if required to achieve a positive real level by June 30, 1989;

- devalued the Zaire currency by 23 percent between January 1st and April 21st in US dollar terms and agreed to bring the differential with the parallel market rate to less than 10 percent before the SAF is presented to the IMF Board;

- created a light oversight unit to carry out the Public Enterprise reform;

- increased substantially the availability of foreign exchange to the private sector;
- cleaned up the PIP of questionable projects, including deferral of the Mushie Pentane sugar project ($120 million) until it is proven economical, and deferral of the purchase of additional turbines under Mobayi II project to enhance its economic rate of return; the PIP is now generally satisfactory and the Government has agreed not to go ahead with projects outside the PIP without the Bank's approval;
- cancelled options on 5 commercial jets, costing between $3-4 hundred million;
- cancelled/reduced drastically contracts for purchases of 1,200 buses to get the number down to a level which is consistent with urban transport needs and the utilization of which by private and public sector bus companies will be determined in agreement with the Bank; and
- allowed the Bank to identify sources of extrabudgetary financing (GECAMINES, the copper mining company, and short-term borrowing) and agreed on procedures (GECAMINES dividends policy and monthly reporting of expenditures) to safeguard against a repetition of past practices.

Specific Conditions for the Release of the Second tranche of the Credits

9. The conditions of tranche release are presented in Schedule 4 of the Development Credit Agreement which is attached to this memorandum for your reference. The actions taken and progress achieved in relation to these conditions is summarized below:

1. By May 10, 1989, President Mobutu is expected to sign the Policy Framework Paper 1989-92 and, on May 8, 1989, the Prime Minister transmitted the Public Investment Program 1989-91; both documents are generally satisfactory to the Bank;
2. the Portfolio Supervisory Board, an oversight structure for supervision of public enterprises, was established in January 1989 and its head appointed in April 1989;
3. over the period May 1988 - February 1989, enterprises have been classified according to whether they are to be maintained in state portfolio, liquidated or wholly or partially privatized;
4. a restructuring and reorganization program for public enterprises remaining in the state portfolio has been finalized in February 1989; the program will guide the

preparation of specific plans for individual enterprises; and

5. the Government has completed financial and administrative arrangements for the retirement of eligible public employees.

10. The related documentation has been reviewed by AF3 staff and found satisfactory. Despite the long hiatus in the implementation of the structural adjustment program, I am now satisfied that the program is back on track and the Government has complied with the specific conditions for second tranche release. I, therefore, recommend the release of the second tranche of the Credits. However, we plan to withhold the formal tranche release until President Mobutu has signed the PFP. The tranche release would clear the way for substantial quick-disbursing assistance by other donors which had been blocked pending an agreement between Zaïre and the Bank/Fund on a macro-framework. A draft Notice to the Executive Directors reviewing program implementation progress and announcing the tranche release decision is attached for your approval.

PFP

11. The negotiated PFP has been updated to reflect 1988 developments. Although the policy framework is substantially the same as was approved by the Operations Committee in May 1988, it was strengthened to tackle the worsening fiscal and monetary situation. Revisions were also made to reflect a higher private sector share in total projected investment compared to the 1988 draft which was too low. The language on GECAMINES' dividend policy (PFP para 47) and on expenditure control procedures (PFP paras 38-40) has been strengthened after my meeting with President Mobutu. It is understood that, prior to presentation of the Structural Adjustment Facility to the IMF Board, a further adjustment of the exchange rate will take place. The medium-term scenario is consistent with the Bank's objective to reduce inflation and restore growth with equity. Annual GDP real growth is programmed at 3.3% in 1989; 3.5% in 1990; 3.7% in 1991; and 4% in 1992. Increases in private per capita consumption and in investment are also projected. The programming and composition of public investment are improving. The resources required to finance the projected gap would consist of a combination of debt rescheduling, debt relief, an ESAF -- if Zaïre becomes eligible -- and increased concessional aid, particularly under the SPA.

Energy Sector Credit

12. It is essential that the adjustment program the Government has recently reactivated be adequately financed to ensure its sustainability over the medium-term and to prevent a recurrence of the underfunding that was partly responsible for the slippages of the 1983-86 reform program. Our strategy before proceeding with SAL II is to prepare several sector operations with tight conditionality and appropriate disbursement arrangements linked to frequent performance reviews until Zaïre re-

establishes the credibility that it can live up to international commitments. The Petroleum component of the proposed Energy Sector Credit fits these requirements. It would support much needed liberalization of the Petroleum sector, a logical next step to the pricing measures the Government recently took, and it would provide a vehicle for required resource transfer while, at the same time, enabling the Bank to monitor closely key macroeconomic performance indicators as well as progress of the sector policy reforms.

cc: Messrs. D. Hopper, E. Stern, S. Husain, A. Karaosmanoglu, W. Thalwitz, V. Rajagopalan, S. Fischer, I. Shihata, D.J. Wood, H. Vergin, A. Shakow, J. Holsen, V. Dubey, D. Lee, D.C. Rao, Burmester/Thahane, R. Liebenthal, A. Steer, T. Baudon, D. Bock, D. Goldberg, R. Frank, J. Parmar, G. Pfeffermann, J. Baneth, B. Kavalsky, S. O'Brien, S. Denning, C. Ohri, H. Wyss, P. Isenman, B. Varon, J.L. Sarbib, M. Schloss, L. Christoffersen, N. Gorjestani, M. Blanc, A. Colliou, A. Otten, M. Peñalver, S. Capoluongo, J. de Leede, P. Lazar, J. Chevallier (RMZ) U. Thumm, G. Sicat, T. Jones, Ms. M. Guerard, Ms. C. Ely-Hachana

Attachments

SCapoluongo/sc/mmmw

(secundo)

Mr Qureshi

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

890512017

1.

DATE: May 12, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V Dubey

EXTENSION: 78051/2

SUBJECT: CHILE - Proposed $130 Million Financial Markets Loan, IM - Agenda

1. The Operations Committee will meet on Friday, May 26, 1989 at 4:00 p.m. in Room E-1243 to discuss the Initiating Memorandum for a proposed $130 million Financial Markets Loan to Chile. The Committee may wish to discuss the issues as set out in paras. 3-6.

Background

2. The proposed loan is a hybrid operation with a quick-disbursing component of $75 million and a credit line of $55 million to be channelled through the leasing subsector. In addition, a $2 million technical assistance component is added to the operation which will be financed under the Japanese Grant Facility. The planned operation is well within the parameters of the lending program laid out in the April 1988 CSP where it was proposed as a hybrid operation with a quick-disbursing component whose actual size would be flexibly determined in line with Chile's balance of payments situation and prospects.

Issues

3. There are three key issues which the Committee may want to raise: (i) do the country's current balance of payments situation and prospects justify the use of quick disbursing resources; (ii) do the additional policy reforms (over and above those supported through the three SALs) justify the size of the loan; and (iii) does the earmarking of part of the proceeds of the loan run counter to the general thrust of the financial sector reforms?

4. Quick-Disbursing Component. The current balance of payments situation and medium-term prospects are better than anticipated at the time of the CSP (about a year ago) when this operation was proposed as a hybrid operation. Actual copper prices are even slightly higher than the Bank's official projections used in the IM (table 1 and annex 4). While higher copper prices could turn the gap projected for 1990 into a reserve build up and considerably reduce the gaps projected for 1991 and 1992, the debt burden is still heavy with debt service in relation to exports on the order of 50 percent and interest payments in relation to GDP on the order of 9 percent. At the same time, the full impact of the fruit export crisis may not have been adequately captured in the balance of payments projections presented in the IM. It is against this background of uncertainty that the Committee may want to discuss the justification of the use of quick-disbursing resources (which as Mr. Loh's May 4, 1989 memorandum points out could be used for debt-reduction purposes).

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5. Strength of the Reform Program. Annex 1 presents a good overview regarding the scope of the reforms to be supported by the proposed operation, in relation to the progress already achieved during 1985-87 in the context of three SALs. The question to be raised would be whether the proposed loan amount is commensurate with the incremental reforms envisaged.

6. Earmarking of Loan Proceeds. In paras. 76-77 it is proposed to channel the $55 million credit line component exclusively through the leasing subsector. Similarly, the Second Industrial Finance Project (approved by the Board on May 11, 1989) is based on intermediation exclusively by commercial banks. The question to be raised would be whether this earmarking does not support the segmentation of the financial market which all the reforms to date helped to overcome.

OC Members

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Rajagopalan, Fischer, Shihata, Wood, Vergin.

cc: Messrs. Lee (COD); Shakow, Liebenthal (SPR); Holsen (CEC); Rao, Steer, (FRS); Burmester/Thahane (SEC); Baudon (SVPOP); Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Sethness (CCM); Frank (CFP); Parmar (CIO); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); (Ms.) Haug, Tanaka (EXC); Robless (OPNMS); Selowsky, Bottelier, Scherer, Bery, Tyler, Fleming, (Ms.) Jones-Carroll, Levy, LAC.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 25, 1989

TO: Mr. Moeen A. Qureshi

FROM: Ping-Cheung Loh, Acting RVP, LAC

EXTENSION: 38692

SUBJECT: CHILE: Debt Reductions in the Context of the Financial Markets Loan

1. In your May 11 meeting with Finance Minister Enrique Seguel, the issue of a multilaterally-supported debt reduction operation for Chile was raised, possibly in the context of our proposed Financial Markets Loan. In preparation for the Operations Committee meeting on this loan, this memorandum sets out our current state of thinking on debt reduction for Chile, and the issues on which senior management may want to provide further guidance.

2. On economic grounds, there is a case for a debt reduction operation for Chile. While currently Chile's balance of payments situation is comfortable, probable deterioration in international copper prices and renewed amortizations of its debt to commercial creditors are expected to generate sizeable financing gaps starting in 1991. Financing gaps are expected to persist even if commercial creditors agree to refinance maturing debt. Therefore, efforts to reduce net financial payments abroad (that until 1995 are expected to range between 7 and 9.5 percent of GDP), through a debt reduction operation, would be beneficial to the growth prospects of the economy. Besides the purely economic merits for debt reduction in a country with a debt/GDP ratio that is twice the average for all Latin American countries, we also feel that as a good economic performer, Chile should benefit from any funds available for a debt reduction operation.

3. Because time is short before the December 1989 elections, the Chilean Government is interested in a simple operation that falls within the confines of the existing 1988 agreement with its commercial creditors. This will avoid the need for waivers requiring the consent of all creditor banks. The 1988 agreement permits the Chilean Government to utilize US$332 million (US$500 million minus US$168 million already used for a debt buyback in 1988) for debt reductions or conversions. The Government expects these funds to be equally financed by the Bank, the IMF, the Copper Stabilization Fund, and the Japanese. In case the Japanese cannot operate expeditiously, the Government is willing to proceed with only the other two multilateral institutions. Staying within the confines of the existing bank agreement will allow the Government to conclude such an operation by September or early October.

4. A straight cash buy-back operation of US$330 million will allow Chile to retire US$550 million in outstanding debt, generating a rate of return of 19 percent. This assumes that debt can be purchased at 60 cents to the dollar. (Chilean debt is currently trading between 58 and 59 cents to the dollar.) There are other alternative operations that we have explored, like a bond exchange that secures principal and provides credit for a two year interest payment which would convert US$1.5 billion in

outstanding debt, and provide an internal rate of return of 24 percent. These alternatives we propose to share with the Chilean Government for their consideration. Either type of operation generates an acceptable rate of return.

5. As noted in the May 10 memorandum to you, there is an ongoing consultative process on a possible debt reduction exercise for Chile between the Bank and the IMF. An IMF mission is currently in Chile to negotiate a Stand-By arrangement and to conduct the 1989 Article IV consultations. The IMF is exploring the possibility of availing their proposed Stand-By loan (equivalent to US$100 million) for debt reductions. However, as is the case with the Bank, the IMF mission is waiting for Board guidelines in order to proceed to more substantive negotiations on debt reductions with the Chilean Government.

6. The current Government is predisposed to proceed with the debt reduction exercise if external resources become available. The position of a new Government assuming power in March 1990 is less clear. The expectations raised by Mr. Brady's proposals have led some opposition groups to assume that Chile, and other countries, will eventually not have to honor fully their debt service obligations. Consequently, they would prefer to direct windfall copper revenues towards internal expenditures. We believe that this Government could leave a positive legacy for the incoming democratic Government by moving expeditiously but transparently now to reduce external debt. Additionally, the economy has recently been showing signs of overheating, and any large accumulation of international reserves, such as the Copper Stabilization Fund, will provide a temptation to follow expansive policies at a time when prudence is needed.

7. Depending on the participation of the Japanese, the Bank is expected to be asked to contribute between US$80 and US$110 million in the debt reduction operation. As you are aware, we are proposing that the US$75 million fast-disbursing component contemplated for the Financial Markets Loan be slightly enlarged and made available as our contribution to a debt reduction program. The Financial Markets Loan is targeted to go to the Board in September, which is within the time parameters for the debt reduction operation.

8. We would appreciate your guidance on whether the Bank's participation in the proposed debt reduction operation can be carried out using the fast-disbursing component of the Financial Markets Loan. If you agree with this approach, we could present this option to the Chilean Government in the next few weeks and support the finalization of such an operation within their preferred time frame.

Cleared with and cc: Messrs. Flannery (DFS); Bottelier (LA4DR)

cc: Messrs./Mesdames Morais, Duvall (VPLEG); Ludvik (VPCOF); Bock (o/r) (DFS); Dubey, Thumm (EAS); Husain o/r, Selowsky, Martin, Dolenc (LACVP); Rowat (LA4DR); Bery, Tyler, Jones-Carroll, Lashman (LA4CO); Scherer, Fleming (LA4TF); Collell, Mettala (LEG); Sugar (LOA)

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The World Bank

ERNEST STERN
Senior Vice President
Finance

May 8, 1989

Mr. Qureshi

Moeen -

The note on the Financial Markets Loan to Chile seems fine, in terms of the allocation of funds for debt reduction. While, perhaps, more can be done in the future, in light of Chile's track record, it seems to me that we should also insist on the use of the funds in the Copper Stabilization Fund for any debt reduction effort. The former Finance Minister started to use this Fund for debt buybacks, as originally intended, but stopped in face of political opposition. Debt or debt service reduction should not become the exclusive preserve of new borrowed external capital.

cc: Mr. Wood
Mr. Rao

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

890413012 1.

DATE: April 11, 1989

TO: Mr. Moeen A. Qureshi

THROUGH: Mr. S. Shahid Husain

FROM: Pieter Bottelier, Director, LA4

EXTENSION: 39378

SUBJECT: **CHILE: Proposed Financial Markets Loan**

1. Attached for consideration by the Operations Committee is the Initiating Memorandum for a proposed Financial Markets Loan for Chile. The proposed hybrid operation of US$130 million includes a fast-disbursing component of US$75 million, and a line of credit for leasing and technology development of US$55 million.

2. As you are aware from the Country Strategy Paper (discussed by the OC on May 4, 1988), our strategy in Chile is to execute a gradual transition from structural adjustment lending to other modalities in a fashion that does not lead to excessive volatility in the Bank's net disbursements to Chile. Our ability to implement this strategy is influenced by the Government's very disciplined and restrictive view of the public sector's role in the economy and our inability to participate financially in the only productive sector which has remained substantially in the public domain: copper.

3. The proposed operation is intended to form an integral part of the above strategy. It responds to the request from the Chileans for the Bank to maintain its involvement in the financial sector, which has been a major arena of Bank involvement under our three SALs to Chile. Largely due to this previous involvement, we are at the stage where there are relatively few major distortions remaining in financial markets, and the challenge is to create a regulatory environment which supports private securities market development, linked to the resources available to the privately administered pension funds (AFPs). Accordingly, conditionality of the loan focuses on rekindling activity in the corporate bond and equities markets. Furthermore, the loan will strengthen the commercial banks by enhancing the range of their permissible activities. The proposed loan would thus be a natural sequel to the SAL program and contribute to a significant further development of Chile's domestic financial markets.

4. At current, historically high, levels of copper prices, Chile is expected to be able to finance adequate import levels on the basis of projected exports and identified sources of financing. Notwithstanding this relatively comfortable short-term situation, the Chileans have requested that we proceed with fast disbursing assistance as a component of the proposed loan. We feel that such a request should be sympathetically reviewed for several reasons. First, the current balance of payments ease is clearly temporary and the result of a windfall gain. During the last two months, volatile

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copper prices have moved erratically in the US$1.50/lb. to US$1.30/lb. range. These gains ought to be sequestered for the troughs in the copper cycle and this is indeed what the Chileans are doing via the Copper Stabilization Fund. Second, the amount of quick-disbursing assistance proposed still would leave the Bank in the zone of marginally positive net disbursements, which is, in our view, the right posture for the Bank to adopt in the transition from structural adjustment lending to sectoral and project investment lending. Third, the Chileans do count on the Bank as a stable source of external finance, and believe in a strong reserves position as an integral part of their policy both to maintain domestic confidence during a sensitive period of political transition, and as a source of financing for possible debt buybacks. They are also extremely concerned that their past good performance not be a basis for them now to be penalized in their access to Bank funds.

4. Finally, as you are aware, following the recent "fruit episode," the Chileans had approached us requesting freestanding line of credit assistance to counteract any possible shortfall in credit for working capital that may rise from increased perceptions of market risk on the part of the current providers of this credit. We have already conveyed to the Chileans our view that a specialized credit line would be inappropriate; however, the proposed quick disbursing component could serve as a general source of support if the Chileans' fears for the next season were in fact realized.

5. From a country relations and strategy point of view, we would wish to process this loan in its proposed form. I would appreciate your views on this matter.

attachment

Distribution:

Operations Committee: Messrs. Jaycox (AFRVP), Karaosmanoglu (ASIVP), Thalwitz (EMNVP), Rajagopalan (PREVP), Shihata (VPLEG), Wood (FPRVP), Vergin (OPNSV)

Mmes./Messrs. Dubey (EAS (2)), Lee (CODDR), Bock (DFS (2)), Hopper (PPRSV), Shakow (SPRDR (2)), Fischer (DECVP), Holsen (CECDR (3)), Baneth (IECDR), Churchill (IENDR), Collell, Mettala (LEG); Thahane (SECGE), Stern (FINSV), Rao (FRS (2)), Sugar (LOA), Frank (CFPVP), Parmar (CIOVP), Lachman (IMF) Segura, Selowsky, Barandiaran, Linder (LACVP); Wessels (LATDR), Iskander (LATTF), Rowat, Berg (LA4DR); Tyler, Jones-Carroll, Levy (LA4CO); Scherer, Fleming, Alber, Garcia-Thoumi, Cortes, Tam (LA4TF)

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May 24, 1989

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THE WORLD BANK

Operations Committee

CONFIDENTIAL

Minutes of the Operations Committee to Consider
COTE D'IVOIRE - Water Supply Sector Adjustment Loan

Held on Wednesday, May 24, 1989, in Conference Room E-1243

A. Present

Committee

Messrs. M. A. Qureshi, Chairman
I. F. I. Shihata, LEGVP
V. Rajagopalan, PREVP
D. J. Wood, FPRVP
E. V. K. Jaycox, AFRVP
W. P. Thalwitz, EMNVP
H. W. Fleisig, Acting ASIVP
R. M. Martin, Acting LACVP
H. Vergin, OPNSV

Others

Messrs./Mmes I. Serageldin, AF1DR
V. Dubey, EAS
D. D. Singh, AF1DR
R. M. Westebbe, AF1DR
A. Soto, AF1IN
R. L. P. Harris, CODOP
P. Lietard, CA1D1
A. Harth, CODOP
M. H. Bouchet, DFS
G. Sicat, EAS
J.-F. R. Dupuy, LEGAF
R. Verspyck, AF1IN
C. L. Robless, OPNSV
M. Guerard, AFRCE
H. P. Crevier, SECGE

B. Issues

1. In discussing the Water Supply Sector Adjustment Loan, the Committee followed in part the Agenda suggested by EAS. The major issues discussed dealt with a review of macro-economic background, the nature of a future macro-economic framework, the link of the proposed sector operation with the macro-economic framework and the sufficiency of a sector adjustment program as contained in the green cover package.

Review of Macro-economic Background

2. In reviewing the macro-economic situation, the Region reported that the Cote d'Ivoire Government has now come to the conclusion that their current economic strategy is not working satisfactorily. The Government now welcomes a joint Bank/Fund mission to help them review their economic program. Certain actions are needed to adjust revenues, public expenditures and the overall investment program. The budget deficit has to be reduced from the present high level of 15% of GDP. A stabilization program would require budget support and debt relief. Looking forward to burden sharing, the Region reported that the French Government, as a major donor, is prepared to contributue its share. Co-financing from the Japanese Government and the African Development Bank is also anticipated. The possibility of a fourth SAL is being discussed.

3. All these actions require, admittedly, difficult political decisions. The difficult political situation has prevented earlier action. The Government is ready to abandon its old policies through a declaration of intent. The Government expected initially to undertake the required actions by October of this year, but it appears now that it is willing to advance these actions to July. In the meantime, the Region further represented that the country had been in a negative cash flow position with respect to the Bank and that some relief can be provided through earlier work on at least one sector operation which would be ready by the time the macro-economic program is put in place.

The Evolving Macro-economic Framework

4. The Chairman said that the question of whether the macro-economic program is adequate would be considered at the time when such a program has been defined. The current situation is that the Government is faced with a serious balance of payments and cash crisis which requires assistance. The present sector operation would be required to go back to the Committee when a macro-economic program, which of necessity has to include the Fund in the picture, is agreed upon. Such a program would assure that other donors would come around to help fill the financial gap.

Link of the Sector Program to the Structural Adjustment Program

5. Since the Region proposed that the sector adjustment program could be considered ahead of the macro-economic program, some members of the Committee questioned the extent to which the sector program depended on the macro-economic program. It was observed that the accumulated arrears equaled the amount of the proposed loan and therefore, the size of the proposed Credit (i.e. the proposed liquidity injection) appeared related to the macro-economic picture. Another issue that came out was whether there was a structural adjustment anchor for the macro-economic program and the necessity of tranching was questioned.

6. The Region replied that the proposed sector loan is sufficiently independent of the overall macro-economic program. A successful macro-economic program would not affect the resolution of the sector issues. These had to be addressed separately. As to the financial gap within the macro-economic program, the proposed loan would only fill a small part of it. However, the loan would be crucial in meeting the present requirements together with the sector operations that are planned in the agriculture and energy sectors. Along with the IMF macro-economic program, these two sector Credits and the present Water Supply and Sanitation Sector Credit constitute the three operations on which the structural adjustment program is anchored. The Region pointed out that the sector restructuring had contributed to the aggravation of the fiscal picture because of the decline in water revenues as a consequence of tariff adjustments. In this context, the Credit was related to the bigger macro-economic program.

Adequacy of Sector Reforms

7. The Chairman observed that the sector adjustment program was not clearly explained in the green cover President's Report. It gave

the overall impression that the program represented largely a transfer of water facilities to the local communities, that arrears had to be cleared and there was no investment component to support. Such a view would send the wrong signal to borrowers that loan money was moving to finance inadequate sector reforms. One member questioned the policy directions in the sector, asking why water service, which is mainly extracted from groundwater, should cost so much in a country where such was relatively abundant. He expressed the view that the program would be privatizing the profitable and easier urban water operations to a monopoly, and transferring the more difficult and costly rural water systems to village communities. He doubted the transferability of the experience of other countries in this context and suggested the need for technical assistance to study these issues. A comment from another member noted the absence of link of the conditionalities to benefits from the reforms, be they social, private or environmental. Another member felt that while he was initially skeptical, he saw some merit in the objective of a truly private sector operation of water services; however, the program lacked a long term definition. In the course of this long discussion, the content of Annex 3, which described in detail the statement of policy of the water supply and sanitation sector, was referred to as revealing more important aspects of policy changes in the sector that were not reflected in the main text of the green cover President's Report.

8. The Region explained the various components of the sector program in detail. The restructuring of water tariffs represented a significant effort because this corrected the distortions which significantly penalized the industrial users. The tariff reductions implied loss of revenues which required interim support in the adjustment program in order to bring back the system to a more efficient delivery of services. There is no investment financing in the project because this is being developed in the context of a privatized utility sector. However, incentives to investments are improved through the institutional changes that were being adopted, especially in the context of the basic changes in the nature of contractual arrangements through the use of concession systems. As to the criticism that the profitable parts of the system were being privatized in a monopoly, there was to be continued Government supervision and regulation of the private sector. What was hoped to be accomplished by this changed incentive structure is to encourage risk taking by the private sector which would improve investment in the sector.

Decision

9. The Chairman concluded the meeting by stating that the green cover President's Report needed further revision in order to convey the sectoral policy changes already spelled out in greater detail in Annex 3 and to integrate these into the conditionalities of the proposed loan. The revised sections of the President's Report should be circulated to the Operations Committee. He also did not see the need for front loading as suggested in the document.

G. Sicat

GSicat:sb

May 31, 1989

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Qureshi
E1241

Regarding Coté d'Ivoire Water Supply Loan

May 24

Mr. Qureshi

Moeen:

I think that the Region made a good case in response to your question. Annex 3 contains a lot of information which I had not read. On the basis of that annex, I believe that the policy and institutional changes being contemplated are significant.

I would advise that you authorize the Region to invite negotiation. However, you should ask them to prepare a revised green cover incorporating more of Annex 3 in the text.

Vinod.

Vinod Dubey

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

8905 22006 1.

Contribution of Government

p19-20.

DATE: May 19, 1989

TO: Operations Committee

FROM: Salah El Serafy, Acting Director, EAS

EXTENSION: 78073

SUBJECT: COTE D'IVOIRE: Proposed $80 Million WASAL, Green-Cover Package - Agenda

1. The Operations Committee will meet on Wednesday, May 24, 1989 at 4:30 p.m. in Room E-1243 to discuss the green-cover package for a proposed $80 million Water Supply Sector Adjustment Loan to Cote d'Ivoire. The Committee may wish to discuss the issues as set out in paras. 2 and 3-6.

Background and Macroeconomic Framework

2. As a result of the decline in the world cocoa price and the Government's failure to make the necessary domestic adjustments, Cote d'Ivoire has experienced great economic and financial difficulties during the past two years, with mounting external arrears. An IMF standby arrangement went off track early last year, and joint Bank-Fund efforts have yet to produce an agreement on a stabilization program. For lack of agreement on an adequate macroeconomic framework, three proposed sector adjustment loans have been on hold for almost two years. A Fund mission (with Bank participation) is in the field, and the Region could be asked to report on the status of negotiations and the main features of the expected program as well as the prospects for a financing package with acceptable burden sharing. (There may be a need for another OC review of the loan package, once agreement on a macroeconomic framework and stabilization program has been reached.)

Sector-Specific Issues

3. The water-sector reforms have been initiated in 1987 and major progress has already been made with regard to the institutional setting (paras. 58-60 of the PR) and to cost and pricing (paras. 63-64). The additional measures summarized in paras. 75-77 and annex 4 would be important steps towards greater efficiency and financial viability of the sector and, in time, would make a positive contribution to overall fiscal improvement. However, a number of questions could be raised.

4. Loan Amount and Front-Loading. In addition to the institutional reform and efficiency measures, the sector needs financial restructuring to refinance, on a long-term basis, accumulated debts and an incremental deficit resulting from the Bank supported water rate adjustments on a long-term basis. The financing needs are estimated to amount to CFAF25 billion, equivalent to about $80 million (paras. 52-53). The proposed loan amount is $80 million and would, therefore, finance 100 percent of the required consolidation. The question is whether the government should not be required to make some contribution. A related question is how the proposed operation would be factored into the expected Fund program. (The whole loan disbursement could conceivably be used to reduce the balance in the operations account at the West-African Central Bank (BCEAO).) Finally, in ?

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the same context, the question could be raised, whether the first tranche proposed to amount to $57 million (or over 71 percent) would not be too high (even if one recognizes the Government's prior reform actions).

5. Financial Monitoring. The reform program is expected to contribute to a substantial financial improvement of the sector over the medium to longer term (although the improvements are partly due to a decline in debt service payments which is independent of the reform measures). However, the proposed loan conditionality does not provide for specific assurances regarding monitorable financial improvements. While one has to recognize that the sector would be essentially privatized (and thus beyond direct government control) as a result of the reform, the Region could be asked to explore the possibility of strengthening the conditionality with regard to the liquidation process of FNA/FNH and its financial impact on the newly created Fund (FNE) (para. 67). This could be, for example, in the form of phased targets for financial ratios akin to those normally specified in project loans, which--in addition--could be used to link the disbursement of a portion of the loan to specific progress in such financial ratios.

6. Disbursement Against General Imports. Although the proposed operation is a sector adjustment operation, disbursements will be against general imports, subject to a negative list. While this may be the only practical way to generate the fiscal support needed for debt consolidation and general import financing would be justified by the (expected) existence of an adequate macroeconomic framework conducive to an improved balance of payments situation in the future, the Committee may want to consider this issue explicitly.

OC Members

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Rajagopalan, Fischer, Shihata, Wood, Vergin.

cc: Messrs. Lee (COD); Shakow, Liebenthal (SPR); Holsen (CEC); Rao, Steer, (FRS); Burmester/Thahane (SEC); Baudon (SVPOP); Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Frank (CFP); Parmar (CIO); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); (Ms.) Haug, Tanaka (EXC); Robless (OPNSV); Serageldin, O'Brien, Westebbe, Landell-Mills, Soto, Kaps (o/r), Verspyck, AFR.

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May 17, 1989

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The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee Meeting
to consider ALGERIA - Economic Reform Support Loan

Held on May 17, 1989, in Room E-1243

A. Present

Committee	Others
Messrs. M. A. Qureshi, OPNSV	Messrs. M. Ahmed, EM2IE
W. Thalwitz, EMNVP	T. Baudon, OPNSV
S. Fischer, DECVP	I. Christin, CA1DR
E. Jaycox, AFRVP	K. Dervis, EM2DR
H. Vergin, OPNSV	Ms. S. Hadler, FRS
H. Scott, LEGVP	P. Hasan, EMNVP
M. Selowsky, LACVP	H. El-Naggar, EM2IE
A. Steer, FRS	S. El Serafy, EAS
H. Fleisig, ASIVP	F. Fornasari, EM2CO
	N. Krafft, EM2AG
	A. Khadr, EM2CO
	G. Reif, SPRPA

B. Issues

1. The Operations Committee met on Wednesday May 17, 1989 to discuss the Initiating Memorandum/Preappraisal Package for an Economic Reform Support Loan in the amount of $300 million. The discussion followed broadly the agenda prepared by the Economic Advisory Staff, and focused on the macroeconomic framework and the debt problem, exports and investment projections, loan conditionality, retroactive financing, the environment and the social cost of adjustment.

C. Discussion

2. At the invitation of the Chairman the Region made an introductory statement. It emphasized the speed with which the reforms in Algeria, which began only in January 1987, have gathered momentum, indicating a clear will for reform. Implementation, however, remains weak and needs careful management. The Fund was now a full player on the Algerian scene, with a Stand-by covering calendar 1989 (to be considered by the Fund's Board on May 31) as well as a Compensatory Financing Facility operation, both aggregating some $600 million. The macroeconomic program for 1989 is being supported by the proposed loan as well as by the Fund's Stand-by. Before second tranche release, whether or not a Fund program is in place, the Fund has agreed to review the macroeconomic situation with the Bank. The Region added that the present version of the President's report will have to be edited as it now contains statements more suited to an IM. Finally, the Region stated, staff working on Algeria are aware of the potential the present situation is offering and are enjoying the current dialogue.

3. In view of the massive institutional changes underway it was not possible to specify beforehand the macroeconomic parameters necessary to judge the progress of the program at the time of the second tranche in the summer of 1990. That is why a joint assessment with the Fund of the macroeconomic situation at the time seems appropriate. The Chairman commented that while a Fund's role in the review was desirable, it should never be a prerequisite for a Bank program.

4. Pursuing the agenda, the Chairman asked about the macroeconomic situation and the exchange rate. The Region responded that, ruling out a major oil price collapse, the medium-term balance of payments prospects have brightened, now that oil prices have improved and disagreement with France over gas prices has been resolved. Manufactured exports are also expected to grow, but their base remains small. The balance of payments outcome would clearly depend on imports, which had been slashed, but whose inflow is essential for increasing output and lowering the high ICORs. The projected high investment ratios to which the agenda refers do not in all cases represent new investments, but also replacement and balancing of capital equipment as well as housing construction and employment-creating investments, necessary to redress the currently estimated 20% open unemployment. As to the exchange rate, there is a wide gap between the official rate and the parallel rate despite a recent devaluation of 30% in real terms. Whether to close the gap in one drastic devaluation or gradually over a three-year period is debatable, and the current approach which the Algerians have adopted--and which has been accepted by the Fund--is for a gradual adjustment for fear of inflation.

5. The Chairman enquired if there was a target established with the Fund for closing the exchange rate gap and if such a target was incorporated in the Region's projections. The Region said that there is agreement that the rate of 15% real annual devaluation of the past two years would be maintained, and that the Fund could, under the Stand-by, call for consultations at any time if disagreement developed over the program. Projections for workers' remittances, non-traditional exports and budget impact do incorporate the devaluation agreed upon.

6. A speaker doubted the need for a devaluation, arguing that what was more urgently required than the curtailment of aggregate demand was the reallocation of resources away from investment in order to raise the efficiency of resource use. The Region agreed, adding that consumption had been reduced, by perhaps 8% a year in real terms over the past three years, and that for devaluation to work the real economy should be so organized as to be able to absorb and react to exchange rate adjustments. Already this is being done through reforming the Central Bank role, the banking system and cutting the financial link between the Treasury and public enterprises, but the process is still incomplete.

7. A member said that it was important that we gave support to help structural reforms in Algeria. The process was likely to be a long one, and there is advantage in associating the Bank with it from the outset. He was concerned about how relations with the Fund would work out on the macroeconomy, and this does not relate only to Algeria. From what he had just heard the Fund would be "playing it by ear" in Algeria until 1995. Whereas in the text the Region has confined its projections to the next two years, the tables work out these projections to 1995, with assumptions

about the price of oil, diversification of exports and so forth. This cannot just be left to be discussed on an ad hoc basis with the Fund which the last time the OC discussed Algeria was out; now it is in. Important issues such as devaluation have to be discussed, and added that with a 15% real devaluation a year, it was quite unlikely that inflation would remain at 10%. A Country Economic Memorandum could try to resolve some of the more problematic issues in this regard. As to public investment he was in favor of a public expenditure review before second tranche release and the Chairman concurred. He was anxious that Algeria did not go the way of Yugoslavia where inflation derailed the adjustment program. It is very important to realize, he finally added, that the Algerian reform was a very long-term process; an operation like this one, which he fully supported, was not likely to be repeated, but we should be ready with analytical work to help besides, of course, investment lending.

8. Another member was also concerned about inflation as well as its impact on the social cost of adjustment. He was afraid that any faltering of the program might lead to a reversal of direction. He thought that the housing situation should be put in shape as part of the reform program for social and political reasons. To minimize the risk facing the program, imports should also be favored to induce supply response from the productive sectors as well as to accommodate basic needs. The Region said that the monetary situation was a little mysterious with a considerable liquidity "overhang," but the authorities were not expecting inflation to exceed 10%, while the Region was thinking that 15-20% a year should not be considered excessive. In support of the government's position it should be mentioned that some consumer prices have actually been falling as a result of improved competition. Also a lot of imports were coming in at the parallel market for foreign exchange anyway.

9 The Region added that without dealing directly with the interest rate issue, which is being handled jointly with the Fund as part of the overall macroeconomic dialogue, the Bank's program seeks to reduce fiscal funds for the subsidization of interest rates. The Chairman said that it was crucial that the program should be maintained on track and that, if inflation turned out to be higher than expected, the limit on budgetary resources available for interest subsidization might result in the bankruptcy of the institutions involved. A member said that that was a concrete issue that would lend itself to resolution through Bank-Fund collaboration, and the Region added that the whole structure of interest rates needed to be improved in an attempt to unify the market.

10. The Chairman said there appeared to be too many conditions (a speaker said he counted in fact forty such conditions for first tranche release) and that many of these involved new legislation. Some, like improving the accounting system, were necessary for long-term development but should not be loan conditions. The Region responded that the first tranche conditions will have been fulfilled prior to Board presentation, and that most of the laws have been passed. The conditions really refer to implementing these laws. As to agreeing on criteria for a public expenditure review, this was necessary because the Algerians should do it themselves rather than the Region, and the Chairman agreed that the Region were the best judges of using their own resources.

11. A member raised the issue of debt and said he was concerned about the very high ICORs. The Region responded that the ICORs were 7-year moving averages and their trend is certainly declining, albeit slowly. As to the debt the Algerians have sought to avoid rescheduling and the debt problem is now being eased by the improvement of oil and gas prices. Secondary market valuation of Algeria's commercial debt is high (75-80%) and Algeria is afraid to tarnish its creditworthiness by asking for rescheduling at either the Paris or London Clubs. The Chairman, however, thought that when the program began to pinch, rescheduling might be inevitable and we have to keep this in mind.

12. As to retroactivity the Region stressed Algeria's need for quick disbursements; many of the reforms have already been taken, and the 20% of the loan proposed for retroactive financing was within the guidelines.

13. The Chairman then turned to the environment and the social cost of adjustment and the Region said that serious work had already been conducted in the Bank on the environment. This will be discussed with the government before agreement is reached on measures to redress pollution and to strengthen institutions helpful to the environment. The Chairman stressed that behind the environmental issue raised in the agenda was the concern over the sustainability of Algeria's development, dependent as it is on finite resources of hydrocarbons and water. The Region said they certainly were aware of this which will be covered in country economic and sector work. Finally on the social dimension of the program, the Region said that the safety net of subsidization to help the poor was too wide, and that a special mission will visit Algeria to try to make this selective and better targeted to the most vulnerable.

Decision

14. The Chairman summed up by saying that this was a substantive operation that was worthy of support. He advised the Region to cut down the large array of conditions mentioned in the IM, focusing on a few key monitorable conditions for tranche release while agreeing with the government on the rest as part of the program.. Both in the areas of public investment and the rate of interest, while it was important to have a fiscal target, it was equally important to make our approach sensitive and adaptable to changed macroeconomic conditions including inflation. The Committee gave sanction for the operation to be appraised subject to the discussion summarized above.

May 25, 1989

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

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31% GDP [illegible]

Public Investment

DATE: May 15, 1989

TO: Operations Committee

V. Dubey

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78051

SUBJECT: ALGERIA - Initiating Memorandum for an Economic Reform Support Loan

1. The Operations Committee will meet on Wednesday, May 17, 1989 at 4.00 p.m. in Room E-1243 to discuss the "Preappraisal Package" for an Economic Reform Support Loan in the amount of $300 million.

2. On January 9, 1989 the Operations Committee discussed a prototype of this loan, a $150 million Agrarian Reform Support loan, together with a draft CSP for Algeria. It was then decided that loan appraisal was premature in view of the lack of an adequate macroeconomic framework, and that the CSP should be revised. The project under review builds on the agrarian reform operation and addresses a wide range of issues besides, including monetary and fiscal policies, the trade regime, public investment, financial institutions, public enterprises, the environment and population, while attempting to protect vulnerable groups. The policy and institutional changes envisaged are such that they represent a radical change in the previously highly regulated economic system, and internal opposition to the change may be expected.

- The Region might assess government commitment to the reforms and the political feasibility of the program in view of the likely opposition to its implementation.

- Because of the very wide area over which the program is spread, has the Region explored the possibility of dividing it into two or more operations?

The Macroeconomic Framework and the Debt Problem

3. The base scenario elaborated in the IM and reflected in the key macroeconomic indicators (Annex I.A) shows a reversal of the negative GDP growth in 1987 and 1988 to positive growth to 1995 roughly in the range 4.5-5% a year. Total debt at about $23 billion is expected to remain at about the same level until 1992, with a gradual decline afterwards. It is largely on account of the rapid growth projected for exports (rising from $8.36 billion in 1988 to $17.02 billion in 1995) that the current account of the balance of payments and the debt indicators radically improve. According to the IM, only in case of a decline in oil prices (instead of the constant real price projected) will Algeria be forced to seek debt rescheduling. In the same scenario gross investment is maintained at 30% of GDP when clearly excess capacity exists due to previous over-investment in heavy industry. The ICORs shown in the Key Indicators Table (16.6 in 1988, 12.2 in 1989, 11.1 in 1991, etc.) attest to the continuation of the policy of over-investing.

Exch Rates impact on [illegible] [illegible]

- The Region might throw light on the sources of export growth projected, explaining how a debt service ratio of 52% in 1993 declining to 41% by 1995 would be tolerable.

- Whether instead of supporting investment at 30% of GDP this should be lowered and made more focused on removal of critical bottlenecks to release production out of the already sunk capital.

PS must

Loan Tranching and Conditionality

4. The Region is expecting the loan to be appraised in June 1989, with negotiations to be held in July and Board presentation in August/September. The first tranche, for $150 million, will follow on effectiveness and the second tranche would be released, if all goes well, in July 1990. It is a condition of Board presentation that "all actions spelled out in column III of the matrix have been completed" (para. 141). Column III is headed "conditions of first tranche release" and contains a variety of actions some of which are studies, expected in May, 1989, and some are to be monitored at second tranche release. A great many of the actions involve new laws. The magnitude of these sets of conditions seems to take away the claim of "up-front" policy change emphasized in the IM and its cover memorandum.

- The Region might be asked to sort out Board presentation conditions from effectiveness conditions and assess the chances of each being effected on time.

- Would it be possible to avoid the passing of new laws as loan conditions? And does passing laws mean implementation?

5. The second tranche will not be released until a satisfactory assessment with Fund cooperation is reached of the macroeconomic program, as well as numerous conditions are satisfied pertaining to fiscal policy, foreign exchange allocation and the trade regime, consumer pricing policy, the financial sector, public enterprises, and the social cost of adjustment.

- While the conditions mentioned in para. 143 appear to make sense, can they be reduced in number and only key provisions highlighted? Is it necessary, for instance, to spell out undertakings about sub-ceilings on preferential discounting? Or enterprises selling foreign exchange allocations to other enterprises? If the Algerians had been wary of forward conditionality before, should we not be careful not to overwhelm them with an excessive conditionality?

Yes

6. The draft President's Report (para. 150) proposes retroactive financing of $60 million (20% of the loan).

- Can the Region justify this retroactivity in the light of Bank policy in this regard, linking such financing to any foreign exchange costs necessitated by the reforms?

Good question

The Environment

7. The Algerian economy is highly dependent on the exploitation of natural resources including oil and gas, water and soil. Evidence has accumulated of enormous damage to the environment by toxic wastes as a result of heavy petro-chemical sector activity. A Bank report on the environment is yet to be discussed with the Government. Meanwhile the Government would have established by June 1990 (i.e. around second tranche release) a schedule for environmental priority actions, with emphasis on controlling water contamination, and prepared a plan for managing water resources (para. 100). In the policy matrix, however, (Annex II, p. 10) the priority action plan focuses on dangerous waste disposal, with a "medium-term" program to be developed for controlling water contamination and a plan for water resource management. No conditionality is mentioned either for the environment or for the closely related topic of population policy, yet to be developed, although both are described in the matrix as priority areas needing action over the next eighteen months.

- The Region might consider broadening the environmental dialogue to cover the rational management of the finite hydrocarbon deposits of Algeria which, together with the limited water resources, would constrain future development, and whether technical assistance to guide sustainable development planning might not be called for under this operation.

The Social Dimension

8. The operation is said to aim at minimizing the negative effects on most vulnerable groups of the adjustment process. Towards this goal it seeks to build up a data base designed to identify the truly needy. A review will be initiated of the "efficiency" of budget expenditures, especially on food and housing, in order to better focus these expenditures, and also to review the legal provisions touching on human resources and their pay. A plan will have to be prepared by the second tranche spelling out policy on subsidies and how they can be targeted to the truly needed.

- Would the Region clarify how the review of expenditure efficiency will be pursued?

- And would not technical assistance be needed to bring the experience of other countries to bear on this endeavor?

Distribution

Messrs. Qureshi, OPNSV; Husain, LACVP; Jaycox, AFRVP; Karaosmanoglu, ASIVP; Thalwitz, EMNVP; Rajagopalan, VPPRE; Fischer, VPDEC; Shihata, LEGVP; Wood, FPRVP; Vergin, OPNSV.

cc: Messrs. Lee, COD; Shakow, SPR; Holsen, CEC; Rao, FRS; Burmester/ Thahane, SEC; Liebenthal, SPRPA; Steer, FRS; Baudon, OPNSV; Hopper, PPRVP; Bock, DFS; Goldberg, LEGOP; Frank, IFC (CFP); Parmar, IFC (CIO); Pfeffermann, IFC (CEI); Baneth, IEC; Kavalsky, FRM; Ms. Haug, EXC; Tanaka, EXC; Robless, OPNSV; Hasan, EMNVP; El Maaroufi, EMNVP; Dervis, EM2DR; Grais, EM2CO; Ahmed, EM2CO.

SESerafy/lcu

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION Mr. Baudon

E1241

OFFICE MEMORANDUM

89 MAY 10 PM 5:14

DATE: May 9, 1989

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations

FROM: Wilfried P. Thalwitz, Vice President, EMN

EXTN: 3-2676

SUBJECT: ALGERIA: Economic Reform Support Loan
Pre-appraisal Package

1. The purpose of this memorandum is to seek your approval to proceed with the appraisal mission for the above loan, the objectives and content of which are set out in the attached draft President's Report. Given the advanced state of preparation of the project, we believe that this draft provides a more comprehensive basis than an Initiating Memorandum, for the forthcoming OC discussion. It should also facilitate the subsequent processing of the project, which we propose to appraise in early June and bring to the Board during the first quarter of FY90.

2. The design of the proposed project responds to the points raised by the OC last January, when it considered the CSP and an IM for a proposed Agricultural Sector Adjustment Loan. These points were: (i) the desirability of broadening the scope of the project from one sector (agriculture) to a more broad based operation supporting the Government's overall program of economic and structural reform; (ii) the desirability of replacing a single tranche loan based on past performance by a two tranched operation with the associated forward looking conditionality; (iii) the need to strengthen the analysis of Algeria's medium-term macroeconomic prospects and to seek agreement with the Government on its macroeconomic objectives and policies for the next two years; and (iv) clarification of the status of the dialogue between the Algerian Government and the IMF, and the links between a Bank adjustment operation and any parallel Fund program. These aspects of the proposed project are reviewed below.

3. Scope of the Project and Conditionality: The coverage of the proposed project is summarized in Matrix form as Annex II of the President's Report. In effect, the loan now addresses all the key components of the Algerian Economic Reform Program. These include: (i) the strengthening of macroeconomic management tools and the setting of policy targets which will progressively restore equilibrium in the domestic and external sectors; (ii) reform of the incentive and price structure to reduce the distortions and rigidities that currently exist in the goods, credit, foreign exchange and labor markets; (iii) reform of the regulatory and institutional framework for the financial sector to enable it to play a more effective and active role as an instrument of financial intermediation in the economy; (iv) reform of the public enterprise (PE) management and regulatory system to permit PE's to function as autonomous

and commercially oriented enterprises responding to market signals rather than administrative decrees; (v) an enhanced role for the private sector through the progressive elimination of restrictions and controls that have hampered its development in the past; (vi) continued deepening of the reform in the agricultural sector so as to maintain the momentum already generated by the actions of last year and to extend these efforts to the distribution and marketing of agricultural inputs; and (vii) laying the groundwork which will ensure that, in the future, social programs can be better targetted to protect the vulnerable groups from adverse effects of adjustment. Given their comprehensive nature, these reforms will, when fully implemented, transform the very nature of economic decision making in the Algerian context.

4. The scope and conditionality for the project have been discussed extensively with the Algerian authorities, most recently during the April visit to Washington of Messrs. Ghozali (Minister of Finance), Nouioua (Governor of the Central Bank) and Cherifi (Economic Advisor to the Prime Minister). The Matrix of policy measures to be supported by the loan reflects these discussions. Agreement has been reached on all the actions to be taken prior to Board presentation and release of the first tranche of $150 million (column III of the Matrix). Discussions are also well advanced on the priorities for Government action during the next fifteen months and on the key points which will be included as specific conditions for the release of the second tranche of $150 million in mid-1990. These 14 key measures, which are listed in column IV of the Matrix, will serve as a framework for the discussions with the Government during appraisal and negotiations. Substantive agreement on the progress to be made in each of these areas over the next eighteen months will also be a prequisite to proceeding with the Board presentation of the project. However, not all of these will finally be retained as legal conditions of second tranche release in the interest of having a manageable set of second tranche conditions and to take account of the administrative and social constraints on the part of the Government.

5. The most important new development in this regard, however, has been the acceptance by the Algerian Government of the principle of <u>forward looking policy conditionality</u> in its relations with the Bank. As you know, the scope of our previous operations had been hampered by the unwillingness of the Algerian authorities to enter into any formal commitments on future policies in the context of Bank Loans. The Agricultural Sector Adjustment Loan had, therefore, been designed as a one tranche operation justified on past actions. Over the past few months we have had extensive discussions with the new Government on the need for the Bank to be able to monitor formally the realization of the Government's macro and sectoral policy objectives during the course of project implementation. This principle has now been accepted at the highest levels in the country and the proposed loan will be the first to apply this new approach. We have also reached agreement with the Government that the release of the second tranche will be preceded by a detailed review, to be carried in close collaboration with the Fund, of the macroeconomic developments in 1989 and of the macroeconomic targets to be set in the 1990 budget and annual credit plan.

6. <u>The Macroeconomic Framework</u>: Since the beginning of this year, considerable progress has been made by both Algerian officials and Bank staff in articulating the country's medium term macroeconomic and credit-worthiness outlook. In parallel, the staff of the Fund have also analyzed Algeria's macroeconomic situation, particularly as it relates to 1989. The results of this work are summarized in paragraphs 115-140 of the draft President Report. In essence, this analysis shows that: (i) the medium term prospects are favourable on the basis of reasonably conservative assumptions about the evolution of oil prices and other exogenous variables; (ii) that Algeria, nevertheless, faces a tight external payments position in the next two years, mainly because debt service payments are particularly high in relation to exports over this period; but (iii) that the short term liquidity problem has been alleviated to some extent by the recent firming-up of oil prices and by the adoption of a more flexible and aggressive marketing and pricing policy for natural gas exports. The base case scenario projects a steady improvement in the Government's resource position and the overall current account balance. As a result, Algeria should be able to meet its debt service obligations while increasing the availability of imports for both productive purposes and for supplementing the domestic production of consumer goods. Moreover, the projected improvement in its creditworthiness indicators--the debt to export ratio drops sharply from about 250% in 1988 to under 150% in the early 1990's--should enable the country to continue to obtain its external financing needs on a voluntary basis.

7. This scenario is, of course, highly sensitive to the future evolution of hydrocarbon prices. The base case assumes a rather conservative path of roughly constant real oil prices until the mid 1990's and the sensitivity analysis carried out in the report shows that small variations around the base case do not lead to an appreciable deterioration in the balance of payments prospects. But oil prices are notoriously difficult to predict. If there were a sharp and sustained fall in nominal oil prices--say to $10/bbl in 1989 prices (about a third below the base case scenario)--the medium term prospects would clearly be altered. In that case, it is highly likely that Algeria would be forced to reschedule the foreign debt, which would provide short term relief but delay the stabilization of the country's external payments situation. While such a scenario cannot be ruled out, it should be stressed that it would take quite a dramatic turnaround in world oil markets to bring it about. At present, on the contrary, Bank and Fund staff are revising oil price projections upwards rather than downwards from our base case scenario.

8. <u>Role of the Fund</u>: Following a private visit by Mr. Camdessus in December 1988, relations between the Algerian authorities and the Fund have become much more active. Their outcome is the Algerian request for Fund support in the form of a Standby Agreement relating to the first credit tranche ($200 million) as well as assistance under the Compensatory Financing Facility (about $400 million). Both requests will be considered by the Fund's Board at the end of this month and, if approved, the funds will be made available shortly thereafter. This is an extremely welcome development both because the Algerians need the financial support that the Fund can provide and because the participation of <u>both</u> the Fund and the Bank in support of the country's economic reform efforts will enhance the perception of creditworthiness amongst its commercial creditors.

9. A parallel Fund program during 1989 should facilitate the continued collaboration between our two staffs in providing the Algerian authorities with consistent macroeconomic policy advice. The staff work carried out in connection with the Standby has also helped in the elaboration of the macroeconomic framework, particularly as it relates to 1989. Under the Standby Agreement, the Fund will explicitly monitor the evolution of six key macroeconomic variables during 1989. These are: (i) Domestic credit by the Banking system; (ii) government borrowing from the financial system; (iii) the change in gross reserves; (iv) changes in official short-term debt; (v) the overall budget and treasury deficit; and (vi) arrears on external payments. As far as 1990 is concerned, it is not yet clear whether the existing Standby will be renewed or replaced by some other active Fund program. In the event that there is no parallel Fund program in place at that time, we propose that the staff of the Fund be invited to participate in the review of the macroeconomic situation which is planned for end 1989 as part of this operation.

10. <u>Loan Rationale and Risks</u>: Adjustment lending in support of Algeria's Economic Reform is desirable at this time because of:

(a) The historic nature of these reforms which would, if successful, radically transform a centrally planned socialist economy into a market oriented and politically more open system;

(b) the magnitude of the policy and institutional changes <u>already undertaken</u> by the Government (upfront action has been taken);

(c) the scope of the reforms to be undertaken over the next two years, which for the first time, would be covered by forward looking conditionality under a Bank loan;

(d) the impact of a Bank adjustment operation in strengthening the relative position of the reformist camp within the country; and

(e) Algeria's need for balance of payments support over the next two years while debt service payments are particularly high and before the increase in exports (most notably gas) begins to have a major impact on the country's external payments situation.

11. Notwithstanding the above, the final decision to proceed with the proposed adjustment loan must also take into account the risks involved. The process of reform on which the Algerians have embarked is an intrinsically complex and difficult one. The Bank's experience in other centrally planned economies indicates that the implementation of reform invariably takes longer than initially envisaged. Behavioural change is slow and political as well as social constraints create difficult obstacles to overcome. In Algeria, the problem is somewhat mitigated by the fact that the cut in living standards that is required by a major adverse external shock, has already taken place. Moreover, the

objectives of the reform program appear to enjoy widespread support at the highest political level and amongst the majority of the population at large. Nevertheless, Algerian policy-markers will have to carefully monitor the dynamics of macroeconomic adjustment during the transition period so as to avoid the danger of a surge in inflation and to maintain a reasonable current account balance. They must also strengthen the institutional capacity to ensure the early identification of emerging disequilibria, so as to be able to take corrective action against them. Specific measures to support the effective implementation of the reform program are included in the various components of the proposed loan and discussed in detail in paras. 105-114 of the attached report.

12. Finally, in this context it is important to note that the Bank's current exposure in Algeria is low (less than 5%) and remains below 15% through the mid 1990's, even on the basis of an expanded lending program which is itself predicated on continuing progress in the implementation of the reform program. To the extent that there were slippages in domestic policy reform, we would propose to reduce subsequent policy based lending and cut back on new investment projects so as to reduce gross disbursements to around $250-300 million per year over the mid-1990's.

13. <u>Next Steps</u>: Subject to your approval, the appraisal mission would leave for Algeria at the end of May. Negotiations are tentatively scheduled for early July and the loan would be presented to the Board in September 1989.

cc. Messrs./Mmes. Vergin (OPNSV), Jaycox (AFRVP), Karaosmanoglu (ASIVP), Husain (LACVP), Fischer (DECVP), Wood (FPRVP), Shihata (LEGVP), Baudon(SVPOP), Rajagopalan, Colaco (PREVP), Hopper (PPRSV), Shakow (2) (SPR), Baneth (IEC), Holsen (3) (CEC), Churchill (PPRIEN), Petit (PPRAGR), Stern (FINSV), Corbo (CECMG), Dubey (2), El Serafy (EAS), Lee (COD), Bock (DFS), Rao (FRS), Thahane (VPSEC), Frank (CFPVP), Parmar (CIOVP), Anjaria (IMFAFR), Artus, Bornemann (IMF), El-Maaroufi, Hasan, Michalopoulos, Johnson (EMNVP), Dervis, Costa, Ayub, Molineus (EM2DR), Bouhaouala, Blanchi (EMT), Ahmed, El-Naggar, Coudol, Kumar, Carrere (EM2IE), Grais (5) (EM2CO), Hovaguimian (2), van der Mandele (IFC), O'Sullivan, Krafft (EM2AG), Roa (EMTPR), Engelhard (LEG), Fowler (LOA), Amin (EMTIE), Hinds, Rocha (EMTTF) Whitford (EMTEN), Ludwig (EM2IN), Rogerson (EM2PH), Eshelman (EM2DR), Kopp, Nishimizu, Elwan (EM1), Stoutjesdijk, Bhargava (EM3), Lari, Sood (EM4), Hinds (EMTTF), Al-Khafaji (EMTIN), Harbison (EMTPH)
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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 5, 1989

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations

THROUGH: Wilfried P. Thalwitz, Vice President, EMN

FROM: Kemal Derviş, Director, EM2

EXTN: 32776

SUBJECT: ALGERIA: Economic Reform Support Loan

1. Further to our conversation yesterday evening, the current status of processing for this project is as follows: The draft President Report will be circulated to OC members on Tuesday evening for consideration at the OC Meeting scheduled for May 17. I will be able to provide you with an advance copy on Tuesday morning. As regards the briefing for Mr. Conable, we would appreciate your conveying the following key points:

2. Adjustment lending in support of Algeria's Economic Reform is desirable at this time because of:

(a) The historic nature of these reforms which could, if successful, radically transform a centrally planned socialist economy into a market oriented and politically more open system;

(b) the magnitude of the policy and institutional changes already undertaken by the Government (upfront action has been taken);

(c) the scope of the reforms to be undertaken over the next two years, which for the first time, would be covered by forward looking conditionality under a Bank loan;

(d) the impact of a Bank adjustment operation in strengthening the relative position of the reformist camp within the country; and

(e) Algeria's need for balance of payments support over the next two years while debt service payments are particularly high and before the increase in exports (most notably gas) begins to have a major impact on the country's external payments situation.

3. The Standby and CFF Agreements with the Fund (total of $600 million, Fund Board approval expected end May) remove the remaining major obstacle for the Bank to initiate adjustment lending. At the same time, the rapidity with which the Fund has processed the two Algerian requests, puts additional pressure on us to respond quickly to our Algerian partners.

4. Notwithstanding the above, the final decision to proceed with the proposed adjustment loan must also take into account the risks involved. The process of reform on which the Algerians have embarked is an intrinsically complex and difficult one. The Bank's experience in other centrally planned economies indicates that the implementation of reform invariably takes longer than initially envisaged. Behavioural change is slow and political as well as social constraints create difficult obstacles to overcome. In particular, Algerian policy-makers will have to carefully monitor the dynamics of macroeconomic adjustment during the transition period so as to avoid the danger of a surge in inflation and to maintain a reasonable current account balance. In our own operation, we will need to ensure that adequate safeguards are built in to identifying emerging disequilibria so as to be able to take early action against them. We expect that these issues will be the focus of the OC discussion on the proposed project and we will communicate the results of this discussion to the President prior to his visit to Algeria.

5. The visit itself, although brief, should be extremely useful in terms of providing the President with a first hand expose of Algerian policy-makers' thinking at the highest level. It will also considerably strengthen the perception of President Chadli and his colleagues as regards the commitment of the Bank to Algeria's reform and economic development efforts. Coming at a time of great emphasis on cooperation amongst the Maghreb countries, the fact that the President would come directly from seeing King Hasan in Morocco, would also provide an additional positive dimension to his meeting with President Chadli.

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The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee Meeting to Consider JORDAN - Industry and Trade Policy Adjustment Loan Initiating Memorandum

Held on May 17, 1989 in Room E-1243

A. Present

Committee	Others
Messrs. M. Qureshi, OPNSV	Messrs. T. Baudon, OPNSV
W. Thalwitz, EMNVP	S. Ghitale, EM3CO
E. Jaycox, AFRVP	S. El Serafy, EAS
H. Vergin, OPNSV	M. Fardi, SPRPA
H. Scott,, LEGVP	Ms. S. Hadler, FRS
J. Holsen, CEC	R. Harris, CODOP
M. Selowsky, LACVP	P. Hasan, EMNVP
A. Steer, FRS	Ms. N. Kirmani, IMF
H. Fleisig, ASIVP	C. Sassapour, IMF
	K. Siraj, COD
	A. Stoutjesdijk, EM3DR
	S. Voyadzis, EM3CO
	J. Wall, EM3DR
	R. Zaborski, EM3CO

B. Issues

1. The Operations Committee met on Wednesday May 17, 1989 to discuss the Initiating Memorandum (IM) for an Industry and Trade Policy Adjustment Loan to Jordan in the amount of $150 million. The discussion followed broadly the agenda prepared by the Economic Advisory Staff and focused on projected growth; the debt problem and the financing gap; the projected decline in budget deficit; the trade regime, and the social cost of adjustment.

C. The Discussion

2. At the invitation of the Chairman the Region made an introductory statement, saying that the rapid growth enjoyed by Jordan ended in the early eighties, with 1988 presenting a sudden crisis. The IMF Stand-by and the current operation are intended to help. While the proposed loan was large in relation to the size of the country, it was still within the quinquennial lending envelope of $500 million -- established in the CSP, which was approved by the OC in early 1987 -- if we take into consideration

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the cancellation last year of about $100 million of previous loans. The substitution of quick-disbursing lending for older projects reflects new priorities after reviewing public sector expenditure in light of changed circumstances.

3. The Chairman noted Jordan's need for adaptation to reduced aid receipts and workers' remittances, and for the reduction of the budget deficit. Economic growth can only offset this trend over a period of time, he said. A competitive exchange rate was therefore critical for the adjustment and asked what the position of the Fund was. The Region responded that the exchange rate was indeed critical and that this was realized by Jordan as early as 1982 when the official exchange rate began to deviate considerably from the parallel market rate. Despite devaluation the gap has remained wide. The recent 30% devaluation was a shock to the system, however, but it was difficult to separate the effect on the Jordan economy of exchange rate adjustments from exogenous factors such as the Iran-Iraq war and the change of oil prices. In response to the Chairman's question whether the IMF would be monitoring the exchange rate, a Fund representative said that though the evidence is not complete the Fund has a favorable impression of the impact of the devaluation, and that the Stand-by will ensure that the rate does not appreciate. If pressure should develop on the balance of payments, Jordan has agreed to adjust the real effective exchange rate rather than resort to short-term trade restrictions. The first review of the program will be in November, but the Fund would be consulted if pressure developed before that. The Region added that exchange rate competitiveness is receiving a great deal of attention in the context of economic and sector work and in the context of the proposed operation. The budget, after serious deterioration, will begin to improve in 1989 as a result of overall reforms. A major difficulty is military expenditure which seems to amount to one third of the allocation made for current and development expenditure. The Region will endeavor to reach an understanding with the Government that this should not rise any further, but in fact should be gradually lowered.

4. A speaker asked if the elections expected in two months might change the personalities in power, thereby affecting the program. The Region said that while they could not predict politics, it was unlikely that the economic priorities will change. Another speaker said that whereas retrenchment was indeed required, he doubted the feasibility of reducing the budget deficit annually by 2 percentage points of GDP as projected, especially against a background of high public sector employment and rising unemployment. A third speaker stated that while the economic scenario projected could in fact happen, it tended to be too optimistic as regards the real rise of investment, GDP growth and export growth. It would be much more useful during appraisal to update the information with the view to projecting more realistically what is actually likely to happen. In this context the Region indicated that the Bank's export growth projections (4-5% per year) were lower than the IMF estimates (11% per year). The Region also said that the projected improvement of the budget was concluded only after careful analysis by the Bank and Fund. There are consumer subsidies in the budget which can be reduced and better targeted to the needy, for instance, by confining them to lower grades of wheat and rice. Credit subsidization could possibly be limited to medium and small scale industry. Unemployment was prevalent not among the low-skilled but

the highly trained, and this would be alleviated by private sector expansion. In response to a question by the Chairman on exports of phosphates and potash, the Region replied that the plan is to process phosphates into fertilizers for exports. Though the trade regime was not too distorted, it was very biased against exports. With the removal of disincentives the private sector should be able to pick up the slack produced by lower public investment. Since the new measures were announced, industrial estates have expanded considerably.

5. A member raised the issue of debt and the financing gap, and the Chairman said that with the Stand-by Jordan seems set for a Paris Club rescheduling, and asked if the whole financing scenario projected was realistic. The Region stated that it was indeed aware of the weak structure of industry and agriculture, and the need to develop new markets and new items for exports and hence increase revenues. However, as the projections are near term, they have to be inevitably conservative: workers' remittances are expected to grow with the expected rise in oil prices, and some cushion is provided in the form of building up reserves. But should the financing plan prove unworkable, Jordan could apply to the London Club for rescheduling. This ought to be an action of last resort as it may prove costly to the Government. There is also the $450 million owed by Iraq, though this may not be payable soon. The Region added that it will work closely with the Government to help reduce the budget deficit.

6. The Chairman asked if the Committee thought the conditionality to be adequate and whether it was in line with the $150 million proposed loan amount. The Region thought the amount was justified by the extent of the reform already undertaken and to be implemented, including the reduction of bias against exports, doing away with import licensing, and the virtual removal of QRs which had affected 40% of value added in the manufacturing sector. In this area the goal is that over three years, import tariffs would be in the range of about 10-30%. The Chairman, however, asked why the institutional reforms under the program could not start earlier than proposed; in fact, he said, there are too many studies. These should be removed from the conditionality with only the substance of the agreements to be reached remaining. The same should apply to the fiscal reform which could also be started earlier since it was critical. Since the IMF will be present, the Bank's role should focus on the supply response, with emphasis on the social sectors and employment generation.

7. The Chairman said that it was not enough just to identify key areas that will relieve some of the pressure in the social sectors. Riots do not happen in a vacuum, but reflect real grievances. He wondered if we could do something quickly for vulnerable groups, however crudely, leaving refinements to a later stage. Maybe it will not be possible, but we should be helpful if we can. The Chairman suggested that the Region allocate about US$10 million from the US$150 million for assistance to reduce the impact of adjustment either within the proposed loan or as a separate activity.

8. Finally, the Chairman said that in view of our exposure in Jordan, the Region should ensure that the amounts proposed for adjustment lending are broadly within the US$500 million lending envelope established in the CSP; our ceiling should be of the order of US$100 million per year. The Bank is only a modest player in financing gap filling, and Jordan has to

look for support from its traditional and new donors, and the IMF. He was not comfortable with the front-loading of the tranches: two thirds to one third, and would prefer half and half.

D. Decision

9. In rounding up the discussion the Chairman emphasized the need to raise public savings largely through developing concrete fiscal measures. It was decided that appraisal of the operation should proceed subject to the discussion and reservations summarized above, with the two tranches being equal rather than in the ratio 2:1, taking into account the allocations for the technical assistance proposed and actions in the social sectors to alleviate the impact of the adjustment.

June 5, 1989

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 15, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78051

SUBJECT: JORDAN - Industry and Trade Policy Adjustment Loan - Initiating Memorandum: Proposed Agenda

Exchange Rate has a role to play

Remittances —

Phosphate + Potash

1. The Operations Committee will meet on Wednesday May 17, 1989, at 3.00 p.m. in Room E-1243 to consider the Initiating Memorandum (IM) for an Industry and Trade Policy Adjustment Loan in the amount of $150 million. The Operations Committee may wish to take up the following issues.

Background

2. Jordan's economy grew rapidly until 1982, fueled by official grants and workers' remittances originating mostly in its oil-rich neighbors, and helped by reasonably good economic management. The population is small (2.7 million excluding the West Bank), and rapidly growing (3.8% a year) and the social indicators are quite advanced. By 1987, per capita income had reached $1,540 (Bank Atlas). Growth, however, slowed down after 1982 when oil prices began to decline. As remittances receded and neighboring markets contracted, exports suffered, and both the budget and the balance of payments current account showed serious signs of imbalance, amounting in 1988, respectively, to 14.7% and 4.7% of GDP after counting grants received. External debt has also become onerous, and is well in excess of GNP, if military debt is counted (see para. 5 below). Growth, which became negative in 1988, is expected to be nil this year, and unemployment, once non-existent, has emerged as a serious problem. Both investment and savings have been declining for several years; so also has been per capita consumption, but inflation, traditionally absent, would reach 14% this year. Adding to Jordan's problems has been recent capital flight in reaction to political uncertainties. Iraq continues in default over payments for exports with a backlog of arrears of $450 million at end-1988. An 18-month Stand-by has been agreed with the IMF and is expected to be taken to the Fund Board in June. Preparation for this operation has overlapped with that of the Stand-by, and the two institutions are in agreement about the necessary stabilization and structural adjustment measures being taken by the authorities. Despite the recent riots, the government has reconfirmed its commitment to the austerity program which underlies the reform being supported by both the Bank and Fund.

The Program and the Macroeconomic Framework

3. The adjustment program rests on a good base of country economic and sector work which has identified agriculture and small and medium scale industry as potential sources of growth. Already the government has announced a reform program whose main features are a floating Dinar (whose overvaluation had been masked by the considerable inflows of remittances and grants); deregulation of interest rates and liberalization of financial markets; initiation of industrial activity deregulation; and an austerity

1989 budget. For the outward looking reforms being sought, a sound exchange rate policy is crucial in the years ahead, and the advent of the Stand-by augurs well for the program. Given Jordan's small productive base, however, and the magnitude of the needed adjustment, the loan aims at supporting the acceleration of the pace of reform and broadening its scope (para. 2.13). A subsequent adjustment operation is foreseen in agriculture as well as another Stand-by.

4. The macroeconomic framework presented in the IM is expected to be clarified and strengthened during appraisal. The main outlines presented, however, are sound, with moderately high growth rates projected for industry, and to a less extent agriculture, and a gradual narrowing of the budget deficit largely through better revenue mobilization.

- The Region might be asked if the projected growth of exports at 4-5% a year can be accelerated through an aggressive exchange rate depreciation policy accompanied by export incentives, which would help raise economic growth.

The Debt Problem and the Financing Gap

5. The IM states that civilian debt in 1988 amounted to 71% of GNP, while the military debt is unknown. Civilian debt service is shown at $605 million and military debt service at $710 million, with a total debt service ratio of 41.1%. About half of the civilian debt is on concessional terms and some 40% is owed to commercial creditors. Total debt outstanding and disbursed (DOD) may be estimated at $6-6.5 billion, equivalent to 130% of GNP in 1988 (167% in 1989, considering the late-1988 devaluation). The financing gap foreseen inevitably translates into Jordan assuming new debt. While the IM hints at a possible Paris Club rescheduling, the large share of private debt in DOD, and the moderate growth of exports, throw doubt on the sharp reduction projected in the debt service ratio to 26.9% by 1992 and 20.9% by 1997 (para. 3.18 and Annex I). The Region therefore may wish to explain:

- The rapid projected decline of the debt service ratio and if this is compatible with the increase of total debt, and whether a rescheduling is expected of commercial debt.

- Whether in calculating the financing requirements and the debt service ratio the IM has exaggerated the likely growth of official grants and workers' remittances (the latter rising by 9% a year in dollar terms -- Annex II), so that the gap shown might be underestimated.

Why are they so optimistic on Debt Service

- Considering the above, whether the exceptional financing gap, estimated at an annual $400 million in the period 1989-92, is not also underestimated, and its filling might not, therefore, be feasible.

Loan Amount, Tranching and Conditionality

6. The proposed $150 million loan, which works to a $56 per capita, is expected to be presented to the Board in August and become effective in September 1989, when a $100 million first tranche will be disbursed,

Jan 89

75-75

3 years [illegible]
why not [illegible] tranches

followed by a second tranche (around June 1990) of about $45 million, with a technical assistance component of "up to" $5 million to finance studies. Loan conditionality is spread over three areas (a) general macroeconomics; (b) industry and trade policy reform; and (c) institutional reforms. The macroeconomic conditionality complements and receives support from the Stand-by. As previously mentioned, maintaining export competitiveness through a flexible exchange rate is essential, and both this and interest rate policy, already largely liberalized, will be assessed prior to second tranche release. A Bank review is projected of public expenditure in support of policies to contain the all-important budget deficit.

- o The Region might spell out the measures to be taken to obtain the rapid decline in budget deficit projected from 14.7% in 1988 to 9% in 1990 and 6% in 1993, and whether these could be identified during the life of this loan and perhaps tied to tranche release conditions?

Decline in budget deficit

7. The trade regime, though apparently not over-protective, is characterized by wide dispersions resulting from tariff exemptions and very high protection of a narrow range of imports. With some exceptions QRs have already been replaced by high tariffs, and the thrust of the proposed reform is the creation of a band of minimum and maximum tariffs of 10-30% in three years, to be obtained initially by a maximum of 50% tariff at effectiveness, and a range of 5-40% by tranche release. Import licensing would be eliminated and the customs code changed by tranche release, and QRs on 11 luxury imports would be replaced by tariffs by December 1989 -- well in advance of tranche release. Complementary measures, mostly to be accomplished by tranche release, include implementing new investment incentives favoring exports and employment creation; narrowing the disparity between interest rates and rediscount rates for the export credit facility; and studying the establishment of a credit insurance program.

tariff rationalization

- o The Committee might consider if the above provisions would be sufficient to give exports the push needed for Jordan's balance of payments and economic growth? Can special measures be included under the program to secure imported inputs and credit for exporters?

8. Among the institutional reforms planned under the program are reviewing the institutional set-up necessary for promoting exports (TOR to be agreed at effectiveness with action program by second tranche); establishing industrial standards; and organizing a new institution incorporating industrial estates and the free zones (TOR for a study by effectiveness and an action program by October 1990).

- o Because of their common purpose why cannot these two studies be merged and the October 1990 deadline be advanced to tranche release?

The Social Cost of Adjustment

9. The IM correctly mentions that poverty in Jordan is limited and confined to the unemployed. Food subsidies, said to be 10% of recurrent budget expenditures, will have to be targetted more towards the needy as subsidies are being squeezed to reduce the budget deficit. Other areas of

relief indicated include targetting expenditures on health and education and raising, through training, the "employability" of Jordanian labor. With unemployment, now estimated at over 10% of the labor force, the likely reverse migration of labor, and the expected slow growth of industry, unemployment looms large as a potential problem requiring strong counter measures. A cushion exists in lower-paid jobs (said to be 20% of employment) occupied by immigrants, since these could be displaced, albeit at a political price. To address all this, two studies are to be agreed at effectiveness, with action plans to be ready, respectively, by tranche release and by October 1990. The Region might:

Employment big problem

- o <u>Explain why these two studies could not be combined in an effort to gauge the dimensions of poverty and work out a master strategy for its alleviation</u>.

- o <u>Comment on the implications for income distribution of the recent income tax law which replaced progressivity by a single tax rate applying to all levels of income (see Annex III, page 1, third column)</u>.

?

<u>Distribution</u>

Messrs. Qureshi, OPNSV; Husain, LACVP; Jaycox, AFRVP; Karaosmanoglu, ASIVP; Thalwitz, EMNVP; Rajagopalan, VPPRE; Fischer, VPDEC; Shihata, LEGVP; Wood, FPRVP; Vergin, OPNSV.

cc: Messrs. Lee, COD; Shakow, SPR; Holsen, CEC; Rao, FRS; Burmester/ Thahane, SEC; Liebenthal, SPRPA; Steer, FRS; Baudon, OPNSV; Hopper, PPRSV; Bock, DFS; Goldberg, LEGOP; Frank, IFC (CFP); Parmar, IFC (CIO); Pfeffermann, IFC (CEI); Baneth, IEC; Kavalsky, FRM; Ms. Haug, EXC; Tanaka, EXC; Robless, OPNSV; El Maaroufi, EMNVP; Stoutjesdijk, EM3DR; Hasan, EMNVP; Bhatia, EM3CO; Voyadzis, EM3CO; Wall, EM3DR; Chitale, EM3CO.

SESerafy/lcu

Macro. Public Expend
Reform
[illegible]

Budget & Debt
Changes in [illegible]

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 5, 1989

TO: Mr. Moeen A. Qureshi, Senior Vice President, OPNSV
THROUGH: Mr. Wilfried P. Thalwitz, Vice President, EMNVP
FROM: Ardy J. Stoutjesdijk, Director, EM3DR

EXTENSION: 32707

SUBJECT: JORDAN - Proposed Industry and Trade Policy Adjustment Loan Initiating Memorandum

1. Attached for your review is the Initiating Memorandum (IM) for a proposed Industry and Trade Policy Adjustment Loan (AL) to Jordan for US$150 million equivalent which reflects the views expressed at the Regional Management Group Meeting. Cofinancing is being sought from the Government of Japan.

2. During Mr. Conable's visit to Jordan in November 1988, the Government requested the Bank to support an adjustment program designed to reverse the rapidly deteriorating economic situation. An exploratory mission in December confirmed the Government's commitment to the program. A preparation mission, which included two staff members from the IMF, visited Jordan in February 1989. The mission assessed the macroeconomic situation and formulated policy and institutional reforms which could complement the Government's ongoing stabilization efforts by stimulating industrial growth and increasing and diversifying exports. The discussions during the preparation mission also underscored the need for a direct involvement of the IMF. Accordingly, an IMF mission visited Jordan in late March/early April for Article IV consultations/use of Fund resources. An agreement with the Government on a standby program was reached on April 11, and the program has just been approved by Fund management.

3. At the heart of the IMF program is a reduction in the budget deficit from the present level of 14.7% of GDP (including grants) to a sustainable level of 6% of GDP by 1993. This will require a reduction by 3 percentage points in 1989 to less than 12% of GDP and a further reduction by 3 percentage points to 9% of GDP by 1990. Such a reduction in the deficit would require measures to enhance revenues as well as restrain expenditures. In the short term this would be achieved by raising petroleum product prices, reducing food subsidies, increasing discretionary taxes on soft drinks and cigarettes and elimination of some production subsidies in agriculture. In the medium term the IMF program includes a full scale review of the tax system before the 1990 budget and a possible introduction of a general consumption tax by 1991. The IMF program also calls for reduced reliance on domestic bank borrowing coupled with tight credit policy for the private sector and monetary expansion to a level consistent with reasonable inflation. With regard to the external sector, the Government has agreed to ceilings on contracting new non-concessional public and publicly-guaranteed external debt. Finally, it was agreed that the Government would request a rescheduling of external debt obligations from the Paris Club.

1647S

4. Price increases associated with the IMF program touched off riots during the third week in April, which began in the south and quickly spread to within 20 kilometers of Amman. H.M. King Hussein's early return from a trip abroad and his quick acceptance of the resignation of the Government of Prime Minister Zaid Al-Rifai on April 24 quieted the situation. A new Government has been constituted under Prime Minister Sharif Zaid Shaker, a former field marshall, confidant and distant cousin of the King. The new cabinet is expected to be a transitional one until general elections, the first in 22 years, can be held in about two months time.

5. While the recent social unrest has underscored the need to include a strong program to protect the poor during adjustment, we believe that the overall reform program enjoys broad-based support within the Government and will be implemented as agreed. Although the cabinet has changed, the ministers holding the key economic portfolios of Planning, Finance, and Industry and Trade, are well known to the Bank. The adjustment program also enjoys the support of the Crown Prince and the King who, upon his return, pledged a program towards democracy but promised no relief from austerity by declaring, "We are going through an economic adjustment phase: those nations which refuse adjustment and adaptation to new situation...are bound to disintegrate and perish".

6. The measures included under the AL are designed to stimulate the most important sources of growth in the Jordanian economy--i.e., the expansion and diversification of industrial output and exports. To achieve this objective, the Bank's program incorporates a three prong approach. The first includes measures to complement the IMF program in ensuring a stable and competitive macroeconomic environment. The second includes measures to improve the efficiency and competitiveness of industry and trade, and the third includes measures to protect the poor during the period of adjustment. While the measures to be implemented under the AL will make a significant contribution to stimulating a supply response, they should be seen as a part of a reform process which has been underway for the past year and a half, a reform process under which significant measures have already been implemented. We have been an active participant in this process and have advocated many of these reforms in our economic and sector work.

7. In sum, the Jordanian Government's response to the deteriorating economic situation has been fast and comprehensive. The Government has shown its commitment to reform by implementing a number of macroeconomic policies and reaching an agreement with the IMF within two months after extending a formal invitation to negotiate. In the area of industry and trade also it has already implemented a number of significant measures. Based on these actions, and its past record of prudent macromanagement, policy dialogue and borrowing from the Bank, I believe we should extend this (AL) as described in the attached IM.

1647S

Distribution:

Messrs/Mdms. Qureshi (OPNSV) (2), Thalwitz (EMNVP), Wood (VPFPR), Shihata (VPLEG), Rajagopalan (VPPRE), Fischer (VPDEC), Vergin (OPNSV).

Dubey, El Serafy (EAS) (2), Ducksoo Lee (CODDR), Bock (DRS), Hopper (PPRS) Shakow (SPRDR) (2), Holsen (CECDR) (3), Baneth (IECDR), Churchill (IENDR), Hudes (LEGEM), Stern (FINVP), Rao, Hadler (FRS) (2), Mills (LOAEL), Frank (CFPVP), Parmar (CIOVP), El-Rifai (MIGPA), Yaqub (IMF), Thomas (CECTP), Liebenthal (SPRPA).

Hasan, Michalopoulos, El-Maaroufi (EMNVP), Voyadzis (LA3C2), Roa (EMTPR), Bhatia (MIGPA), Wall, O'Donnell, Erim, Giddings, Garg, Bhargava, Pommier, Keare, Mertz (EM3), Tarr (EMTTF).

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$700

Composition of the lending Program: 18

adjustments - receptive macro econ:
January

Approach to the London Club,

Commercial Banks.

$ 450 Persuasion

(1)

(2) Implementation Capacity weak

(3) 1 year strategy – Gov.

4) Improving resource use – efficiency in the allocation of resources.

5. Political Costs of Devaluation are not of reducing Consumption

6. Issue is more distribution?

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7. Impt to reinforce the support for

Fischer

How will our relationship with the Fund work out

Fiscal Reforms.

Oil Revenues.

IMF

Longer term framework — Process of working it out.

— Within the framework
15%

— Interest rates +ve only if ~~rate~~ inflation is no more than 15%

— CEM memory

— Public Investment review.

— Buying a seat at the table —
Be in it for the long haul.

Kim Jaycox

Cannot shut off the discussion.
(i) Inflation convergence possibility.
(ii)

WORLD BANK / INTERNATIONAL FINANCE CORPORATION

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P-1852

May 3, 1989

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

8904 28029

Mr. Qureshi

Make the special case in PFP.

DATE: April 28, 1989

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

Dubey

EXTENSION: 78051/2

SUBJECT: GUINEA - Proposed $10 Million Education SECAL, IM - Agenda

1. The Operations Committee will meet on Wednesday, May 3, 1989 at 4:30 p.m. (instead of 3:30 p.m.) in Room E-1243 to discuss the Initiating Memorandum for a proposed $10 million Education Sector Adjustment Credit to Guinea. The Committee may wish to discuss the issues as set out in paras. 5-8.

Background

2. As a result of more than two decades of pervasive mismanagement, the economy of Guinea fell into disarray, and so did the economic and social infrastructure. The education sector has been particularly hard hit, and educational coverage and quality are among the lowest in the world. While the economic policy reforms initiated in late 1985 have begun to show first encouraging results, the education sector continues to suffer from totally inadequate budget allocations, and prospects for improvements without an energetic reform effort are rather bleak.

3. As a result of a Bank sponsored sector assessment, the Government intends to undertake a comprehensive education reform program which would prepare the ground for a long-term improvement of the country's human resource base. Net of efficiency gains, the reform program will result in incremental expenditures on the order of $30 million during 1990-92 (with a foreign exchange component on the order of $9 million), against a background of continued fiscal and balance of payments constraints.

4. Macroeconomic issues are addressed through the ongoing SAL II as well as a second SAF arrangement with the Fund. After major policy slippages during 1988 which resulted in financial difficulties and a depletion of reserves, the program is currently on track. Given the continued need for balance of payments support (with an unfinanced gap estimated in the PFP on the order of $150 million during 1990-92), the Region proposes a quick-disbursing credit of $10 million (with cofinancing on the order of $25 million) to support an ambitious policy reform package in the education sector. The loan would be disbursed against general imports in three tranches over a period of three years.

5. The sector reform program appears to be well designed (if perhaps overly ambitious) and translated into adequate loan conditionality. The Committee may wish to focus on aspects related to the justification of the use of fast-disbursing resources.

Issues

6. The proposed education sector reform program is not "self liquidating" over the short or medium term in the sense that a direct

improvement of the balance of payments cannot be expected from the reforms during a reasonable period of time, but only over the very long run. Nevertheless, the Region makes an attempt (para. 52) to estimate a positive net impact on the balance of payments during 1990-92 as a result of the rationalization of expenditures, which the Committee may want to consider.

7. While there is some discussion of the broader fiscal picture (paras. 53 and 57), the link between the proposed education sector reforms and an improvement of the general fiscal situation (and ultimately the balance of payments situation) remains unclear and raises the question whether the use of fast-disbursing resources is really justified. While the proposed reforms are expected to result in efficiency gains and to mobilize additional resources at the local level and thus contribute, to some extent, to some fiscal improvement, the net impact is still additional spending which, in order to improve the overall fiscal and balance of payments situation (as projected in the annex to the IM which is consistent with the PFP), would have to be compensated by other fiscal measures (increase in non-mining tax revenues; cuts in low-priority expenditures, particularly transfers). The Committee may ask the Region to shed some more light on these fiscal aspects.

8. Even if the fiscal route (from the sector program to an ultimately positive balance of payments impact along the lines of para. 7) could be adequately established, the more general Bank policy question remains whether this would be sufficient to justify the use of fast-disbursing resources for social sector loans (or similar loans without direct balance of payments link).

OC Members

Messrs. Qureshi, Husain, Jaycox, Karaosmanoglu, Thalwitz, Fischer, Shihata, Wood, Vergin.

cc: Messrs. Lee (COD); Shakow, Liebenthal (SPR); Holsen (CEC); Rao, Steer, (FRS); Burmester/Thahane (SEC); Baudon (SVPOP); Hopper (SVPPR); Bock (DFS); Goldberg (VPLEG); Frank (CFP); Parmar (CIO); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); (Ms.) Haug, Tanaka (EXC); Robless (OPNMS); Serageldin, Westebbe, Palein, Kaps/Landell-Mills, Tuluy, Shaw, AFR.

UT

UThumm:vlw

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 1, 1989

TO: Mr. Visvanathan Rajagopalan, PREVP
THROUGH: Mr. Robert Liebenthal, Chief, SPRPA
FROM: Frank Earwaker, SPRPA

EXTENSION: 34688

SUBJECT: GUINEA: Proposed Education SECAL

1. As you know, the Operations Committee will meet on Wednesday, May 3, 1989 to discuss an initiating memorandum for this loan. The agenda prepared by EAS focuses on the general issue of whether this operation and social sector operations in general constitute a suitable basis for quick-disbursing loans insomuch as the benefits of the proposed policy reforms would be long-term and would not lead directly to any improvement in the balance of payments.

The balance of payments link

2. In paragraphs 52 and 54 of the initiating memorandum it is said that the adjustment program includes efficiency improvements in the sector investment program which will result in balance of payments gains of $9.4 million. This link with the balance of payments is, however, unconvincing because it is predicated upon a presumed level of investment "without adjustment" that is unrealistically high. The Region should be asked, in view of the long-term focus of this operation and the likely advantages of a continuous IDA presence during program implementation, whether it may not be structured more appropriately as a sector investment project with disbursements being made against a time-slice of the sector investment program.

Tranche release conditions

3. The matrix of policy actions adds up to a very solid program. Although a lot has been done to streamline the matrix, there is still rather a large number of tranche release conditions (11 for effectiveness, 10 for the first tranche and 6 for the third tranche). The Region should be asked to reexamine the conditions for tranche release with a view to sharpening their focus still further.

cc: Messrs. Hopper, Fischer, Colaco, Linn, Holsen, Corbo, G. Ingram, Shakow, Dubey, Thumm, Serageldin, Palein, Landell-Mills, C. Shaw, Tuluy, M. Wilson.

FEarwaker/fe

May 3, 1989

Mr. Qureshi:

BOP Justification of SECALs

The "Fischer Report" actually advocates flexibility on SECALs. In the relevant paragraph of the recommendations (attached), it is accepted that a program supported by a SECAL may not directly contribute to an improvement of the balance of payments while it could still merit quick-disbursing support provided the overall macroeconomic framework is adequate.

Ulrich Thumm

Attachment

cc: Mr. Dubey

34. In recognition of this, BOP support assistance is recognized as an "extraordinary" form of development finance. One normally expects the recipient country to be making a serious effort to reduce its dependence upon such finance. To insist further that all SECALs should include policy conditions that contribute directly to medium-term reductions in the macro imbalances would restrict the flexibility with which adjustment lending is used. It could also lead to a reduced focus in SECALs on longer term sectoral issues. Instead, it should be possible to use other methods to provide assurance that a recipient of BOP support financing is making a reasonable effort to reduce and eventually eliminate the need for such assistance. As noted earlier (para. 25), the first of the three prerequisites for adjustment lending is an understanding with the government on its overall structural adjustment program, including short-term stabilization as well as longer term development objectives. Monitoring and recording progress in implementing this general understanding provides an alternative approach to obtaining the necessary assurances of the adequacy of the macroeconomic policy framework. A more explicit approach to design, recording, and monitoring than followed hitherto is proposed below in para. 35. Management will reassess the adequacy of this approach in 18 months.

890427006 1.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 26, 1989

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations

FROM: Edward V. K. Jaycox, Regional Vice President, Africa 4/26

EXTENSION: 34752

SUBJECT: GUINEA - Initiating Memorandum for an Education Sector Adjustment Credit

1. Through the attached IM, we are seeking approval by the OC to appraise a US$ 10 million Education Sector Adjustment Credit to Guinea.

2. Background. Guinea's educational coverage is one of the world's lowest (27% gross primary enrollment ratio). In 1988, less than 13% of recurrent expenditure went to education with only 9% of recurrent expenditure in the sector going for non-salary costs (US $0.14 per primary pupil year). Government has embarked on reforms aimed at increasing inputs and expanding primary schooling. With the Bank's help, an interministerial committee has elaborated a sector policy and implementation strategy. Thus, an institutional infrastructure is in place, and Government has begun defining a human resources policy and an education sector adjustment.

3. The public administration reform is progressing rapidly. In the next two years, much-needed salary increases will raise the average civil-service wage by 34%, while the payroll will be cut by 16%. The effect will be to increase the wage bill by 12%. This will exert upward pressure on the allocation of resources to the education sector, because personnel costs are a higher proportion of the MEN recurrent budget (90%) than of total non-interest recurrent expenditure (40%). In addition, demographic pressure to expand the capacity of the system, particularly at the primary level, will require significant increases in teaching staff, which contrasts sharply with the general objective of pruning the payroll. Finally, the benefits of higher salaries will not materialize without increased expenditure on materials to reduce current underspending and to accomodate increasing enrollments.

4. There is thus a conflict: reducing the fiscal deficit precludes the allocation of additional resources to the education sector to the extent needed; however, the civil service salary increase threatens, in this labor-intensive sector, to further erode the already very limited resources available for material consumption, and to prevent the hiring of new teachers. The resolution of this conflict requires an increase in the proportion of recurrent expenditures allocated to both personnel and non-personnel items in the sector. It is to this issue that the operation is directed.

5. The proposed operation. The operation builds on results from sector workshops carried out with the Bank since February 1988. It aims at: (i) providing budgetary support to a vulnerable sector during a period of austerity; (ii) securing the increased expenditure on non-salary items

required for efficiency gains; and (iii) correcting the underfunding and poor management which have led to substandard performance.

6. Government will be expected to: (i) effect efficiency gains with revised staffing ratios; (ii) increase local-government and private resource mobilization; (iii) increase budget allocations for the sector; (iv) extend the SAL-supported public finance management actions to the sector; and (v) ensure that the sector is directly linked with the public administration reform.

7. Sustainability. The sustainability of the education program is dependant on three factors: efficiency gains inherent in the program; additional local-government and private resources generated by the operation; and increases in budgetary allocations that the Government will make during and after the operation. The efficiency gains are directly linked to conditionality and to the increased availability of funds for non-salary expenditures. Additional resources will be generated by a matching fund mechanism. Increased sector allocations will depend on a transparent budgetary process, which will be reinforced and institutionalized by passing all sector funding via the budgetary process, rather than funding direct sector imports. These increased allocations are predicated on the projected rate of growth of nonmining revenue being considerably higher than that of current expenditure.

8. Size of Funds. The size of funds allocated to this operation is linked to the expenditure requirements of the actions included in the program. The current IDA allocation is US $ 10 million. The complete funding of the program implies a total of US $ 35.2 million (of which US$ 11.7 million in foreign exchange). Cofinancing has not yet been secured (although an active dialogue is taking place) and if it does not prove to be forthcoming, the current IDA allocation will be reviewed.

9. Risks. There are two major risks to this operation. First, as disbursements based on a negative list of general imports do not directly address sector requirements, education may not benefit from the increased resources. To address this question, a joint annual review (linked to tranche release) of budget allocations and quarterly monitoring of the budgetary and the expenditure process are included. Second, the adjustment approach requires commitment from Government and will place a burden on the capacity of key units in the MEN. A key test of Government commitment will be the adoption of a satisfactory institutional framework for monitoring the policy elements of the operation. The latter is an effectiveness condition and compliance will be closely monitored. To improve managerial capacity, the program includes the creation of an interministerial monitoring committee (with a small secretariat), a MEN general management committee, and the strengthening of key directorates through training and technical assistance.

10. Bank Policy and the Operation. The operation is consistent with the recommendations of the study "Education in Sub-Saharan Africa" and, if successful, will reinforce those recommendations. It will mitigate some of the transitional costs of structural adjustment and correct the

imbalance between salary and non-salary expenditures in education. It will also lay the foundations for the gradual and coherent expansion of primary education and contribute to the human capital formation necessary to realizing the benefits of the overall structural adjustment process.

Attachment:

<u>Operations Committee Members</u>:

Messrs: Qureshi (SVPOP); Husain (LACVP); Jaycox (AFRVP); Karaosmanoglu (ASIVP); Thalwitz (EMNVP); Rajagopalan (VPPRE); Shihata (VPLEG) (2); Wood (VPFPR); Vergin (SVPOP)

<u>Other Attendance</u>:

Messrs: Lee (CODDR); Dubey (2) (EASDR); Shakow (2) (SPRDR); Holsen (3) (CECDR); Rao (FRSDR); Baneth (IECDR); Burmester, Thahane (SEC); Liebenthal (SPRPA); Steer (2) (FRS); Baudon (SVPOP)

<u>For information only</u>:

Messrs/Mmes: Hopper (SVPPR); Bock (DFS); Goldberg (VP:EG); Frank (CFPVP); Parmar (CIOVP); Pfeffermann (CEI); Baneth (IEC); Kavalsky (FRM); Huag, Tanaka (EXC); Robless (OPNMS); Agarwala, O'Brien (AFRCE); Denning, Aklilu, Ohri (AFRVP); Wyss (2) (AFTDR); Socknat (AFTED); Christoffersen (AFTEN); Serageldin, Singh, Westebbe (AF1DR); Landell-Mills, Kaps, Kuoh, Tuluy, Walters (AF1CO); Cleaver (AF1AG), Poortman (AF1IE); Soto (AF1IN); Palein, Shaw, (AF1PH); van Beek (LEG); Guillou (LOAAF).