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McNamara Papers

Folder 2 of 2

East Africa

E A

Country Statements

ETHIOPIA

COUNTRY PROFILE

BASIC DATA

Population	31.0 mln.
Total Growth Rate	2.5%
Urban Growth Rate	7.3%
Age Structure	
0-14	45.0%
15-64	52.3%
Adult Literacy	15.0%
GNP Total (1979)	US$ 3.9 bln.
Per Capita	US$ 130
Average Nat'l Savings Rate (FY78-80)	2.9%
Investment/GDP (FY78-80)	8.1%
External Debt (1980) 1/	US$ 670 mln.
Debt Service Ratio (1980) 1/	5.6%
of which Bank share	33.0%

	Lending			
	FY74-78		FY79-83 2/	
	$ Million	No. of Operations	$ Million	No. of Operations
Total	231.9	11	478	11
Bank/IDA				
Bank	-	-	-	-
IDA	231.9	11	478	11
% of Lending				
Agriculture	46%		50%	
Transportation	28%		16%	
Urbanization	-		5%	
Water Supply	-		-	
Communication	16%		-	
Energy			12%	
IDF			10%	
Industry & Mining	-		-	
Population	-		-	
Education	10%		7%	
Tech. Assistance				
Non-Project				

1/ Total outstanding and disbursed.
2/ No lending took place in FY's 79 and 80 because of the compensation issue. The program for FY81-83 is indicative only.

ETHIOPIA

Political Background

1. The internal political situation appears fairly stable. Diverging views persist between radical Marxists favoring close Moscow Alliance and those pursuing more moderate and pragmatic socio-economic policies internally and an external policy of least foreign dependence. The Head of State, Chairman Mengistu, moderates expertly between the prevailing views, though basically he appears to favor the more moderate line.

2. Ethiopia appears to have reached an understanding with Sudan over the situation in Eritrea but relations with Somalia remain strained over the situation in the Ogaden. Kenya has joined Ethiopia in warning Somalia from further intrusions into the Ogaden.

3. The extent of Soviet influence will depend mainly on Ethiopia's military needs, and may thus be expected to wax and wane in accordance with the exigencies of the regional conflicts. Ethiopia has a very old tradition of independence and national pride, the maintenance of which can be expected to be given much higher priority than any particular ideology of the moment. Soviet Bloc economic assistance appears to be forthcoming at a slower pace, and in smaller magnitudes, than the Ethiopians had expected. The recent movement toward settlement of compensation issues arising out of nationalization was probably influenced by this, and could herald the beginning of a change in the direction of Ethiopia's international economic relations.

Economic Structure and Development Strategy

4. From FY1973/74 to 1977/78, GDP grew at less than 0.5 percent per annum in real terms. This low growth rate reflected security problems, and the uncertainties, dislocations and resistance which accompanied the economic reforms, as well as the ensuing difficulties in internal marketing and distribution. Production was also constrained by shortages of agricultural raw materials and spare parts, machinery breakdowns, high managerial turnover, labor disputes and negligible new investment. Construction activity declined. Inflation was rampant. Export earnings from coffee were maintained but the value of other exports declined. Imports, on the other hand, grew rapidly. The resulting deterioration in the resource balance was financed up to and including 1976/77 by external assistance, and afterwards largely out of foreign exchange reserves.

5. Against this background, in September 1978, the Government introduced the first "economic campaign" with the objectives of: (i) reducing the current food shortages by intensifying efforts in the organizations dealing with the peasant sector, and by doubling the state farm area; (ii) helping drought-affected highland areas by strengthening afforestation, rehabilitation and resettlement programs; (iii) eliminating current shortages of consumer items and certain construction materials; (iv) improving the efficiency of government agencies and businesses; and (v) increasing foreign exchange availability by promoting exports. Production targets for each of the key sectors were to be achieved partly by the reallocation of resources, and partly by improved discipline and efficiency in the organizations concerned. The economic campaign gave priority to the productive sectors, and tried to im-

prove discipline in public sector organizations. This first campaign ran for one year, ending in June 1979. A second campaign, covering the fiscal year 1979/80, followed. The Government now intends to introduce such campaigns or action programs each year, as part of an evolution towards more comprehensive multi-year planning.

6. During 1978/79, a significant revival took place. GDP is provisionally estimated to have grown by 5.2 percent in real terms, the value of merchandise exports and imports rose and improved project implementation contributed to a substantial rise in external loan disbursements and in project related capital transfers. Hence, the fall in foreign exchange reserves of about US$45 million during the fiscal year was less than the previous year (US$126 million). Total net reserves, at about US$206 million in April 1980, were sufficient to finance about four months' imports at the 1979 rate. The IMF has made Trust Fund loans and also provided assistance under the Compensatory Financing Facility (CFF). At end January 1981, Ethiopia's net borrowings under the Trust Fund had reached about US$32.7 million equivalent and drawings under the CFF stood at about US$45 million. In February 1981, an IMF mission reviewed a government request for a standby arrangement and also a proposal for further drawings under the CFF. The standby is scheduled to be presented to the IMF Executive Directors in May 1981.

7. Preliminary assessments of the 1979/80 grain harvest indicate an improvement over previous years. However, drought struck once again in Ethiopia in 1980 affecting both the northern highlands and the southern provinces. The Relief and Rehabilitation Commission estimated that some five million people were affected and that drought-related requirements included over 280,000 tons of food.

The Adjustment Problem

8. It will not be easy to sustain the revival evident during 1979 given the prospects for a deterioration in the terms of trade, with lower prices for coffee - the principal export - and higher petroleum prices. Secondly, although the volume of coffee exports has continued to rise, and hides and skins prices have remained favorable, other exports have not shown signs of recovery. Thirdly, external assistance commitments have probably not risen sufficiently in recent years to sustain higher import levels. These factors indicate that foreign exchange will become increasingly constrained. The revival in domestic production will also become increasingly subject to capacity constraints, due to the low level of investment during the past few years. The Government, however, has planned for larger production increases for the fiscal year 1979/80, especially in the construction sector, under its second economic campaign. The targets which were set for the various sectors imply a GDP growth rate of 7.3 percent in real terms, which is considerably higher than the 4 percent real GDP growth projected in the latest Bank economic report issued in April 1980.

9. Most of the obvious short-term measures to improve economic performance, such as utilization of excess capacity, plowing additional land, improvement of labor discipline, institution of extra work shifts have been included in the first two economic campaigns. The need now is for measures which will have a longer-term payoff but possibly little short-term impact, such as improved

domestic resource mobilization and pricing policies, better planning, and more pre-investment and project preparation activity. However, the first priority must be given to expanding production capacity in agriculture and industry together with improving basic infrastructure.

Bank Assistance

10. In recent years the relations between the Bank and Ethiopia have been dominated by a compensation issue. In early 1975, the Government nationalized enterprises in which it deemed government ownership or control to be in the public interest. When doing so, the Government stated that fair compensation would be paid to former owners. To implement this policy, it enacted legislation to regulate compensation and established a Compensation Commission in late 1975/ early 1976 to receive and review claims, and to negotiate and reach agreement with former owners on the amount of compensation and the manner of payment. Much time passed, however, with little evidence of progress. In April 1978, we informed the Government that we would not present another lending proposal for Ethiopia to the Board until the process for resolving the compensation issue had been initiated.

11. A beginning was made in late 1980 when the Compensation Commission invited four claimants to Addis Ababa to negotiate, and an agreement was reached with one of them. On the strength of this, we presented a new lending proposal to the Board in late December 1980 and subsequently began to reactivate the Ethiopia lending program. We have stressed to the Government, however, that we are proceeding with new operational work in good faith and that progress on the compensation issue must continue.

12. We plan to assist in particular those productive and infrastructure projects which the Government considers to have high priority, particularly those projects which will promote exports and assist the rural and urban poor. At the same time, we are trying to renew our policy dialogue which has been severely weakened in the wake of the revolution and as a result of the compensation issue. Discussions would focus on issues such as the need to clarify the methods of socialist management, the role of public sector enterprises, the investment program, resource mobilization and the need for an external sector strategy.

13. We are proceeding with the projects included in the first two years of the lending program (FY1981 and 1982) totalling \$272 million or \$4.40 per capita per annum. The program for the later years are indicative at this time and will depend on progress on the compensation issue as well as on economic performance and project preparation. With a per capita income of \$130 in 1979, Ethiopia remains one of the poorest of the poor. Its weak balance of payments position, together with its poverty, suggests the need for very substantial resource transfers. Ethiopia's ratio of debt service to export earnings (8.1 percent in 1978/79) has fortunately remained low, largely because of the relatively low level of external loan commitments in recent years, and because of the tendency of some donors to shift to support on grant terms. Ethiopia has not been considered creditworthy for Bank loans since early 1970s, and in view of its poverty and weak balance of payments position is not likely to become creditworthy for some time to come. The most recent Consultative Group meeting on Ethiopia was convened in July 1973, prior to the revolution. Since then, the Consultative Group has been dormant.

14. The last economic mission visited Ethiopia in November/December 1978. Further economic work demands high priority and, in agreement with the Government, we will mount an economic mission in April 1981. In our economic and sector work program, we plan to emphasize the agricultural and industrial sectors, although the Government will likely remain sensitive to such work until its policies and strategies in these sectors have been clearly defined, and until our dialogue with the Government on such policies has strengthened.

KENYA

COUNTRY PROFILE

BASIC DATA

Population	15.3 mln.
Total Growth Rate	3.9 %
Urban Growth Rate	6.9 %
Age Structure	
0-14	49.5%
15-64	48.0%
Adult Literacy	40.0%
GNP Total	US$ 5,850 mln.
Per Capita	US$ 380
Average Nat'l Savings Rate (74-85)	15.7%
Investment/GDP (78-85)	21.7%
External Debt (1980)	US$ 2,181.6 mln.
Debt Service Ratio (1980)	12.6%
of which Bank share (1980)	15.2%

	Lending			
	FY74-78		FY79-83	
	$ Million	No. of Operations	$ Million	No. of Operations
Total	560.0	25	1086.7	28
Bank/IDA				
Bank/TW	403.0	21 1/	630.2	14 1/
IDA	157.0	12 1/	456.5	16 1/

% of Lending	FY74-78	FY79-83
Agriculture	31.5%	35.5%
Transportation	10.2%	16.4%
Urbanization	11.7%	3.7%
Water Supply	11.6%	1.8%
Communication	-	1.8%
Energy	10.1%	9.7%
IDF	6.2%	6.4%
Industry & Mining	1.8%	3.1%
Population	2.1%	3.7%
Education	5.9%	3.7%
Tech. Assistance	-	0.4%
Non-Project	5.4%	13.8%
Others	3.5%	-

1/ Includes blend operations.

KENYA

Political Background

1. Since Independence in 1963, Kenya has experienced remarkable continuity in political leadership, culminating in the smooth transfer of power following President Kenyatta's death in 1978. In light of the peaceful national election held in November 1979 and the far-reaching government reshuffle in June 1980, it would seem, at least on the surface, that President Moi and his associates are for the time being in control of the political, bureaucratic and military foci of power. But, in spite of the apparent control of the President, the current political situation in Kenya is unsettled, largely as the result of historical tribal conflicts which, while suppressed during President Kenyatta's rule, appear to be taking a more open and concrete shape.

2. The ongoing power struggle has generated some political nervousness. This was demonstrated in the Cabinet's rescinding of national price increases for a number of key consumer commodities in early 1980, and the confrontations with students of the University of Nairobi. Also, there is a lack of internal cohesion within the Government, and this is inevitably hindering efforts to improve the country's economic management and planning capabilities. An important socio-political problem in Kenya, and one that aggravates every other, is the pervasiveness of the corruption that developed during President Kenyatta's regime. Despite his continuous public campaign against corruption, President Moi has rejected the idea of appointing an Ombudsman with broad investigative power.

Economic Structure and Development Strategy

3. Although Kenya has made substantial economic progress since Independence, it remains a poor country, with an average GNP per capita in 1979 of US$ 380. Agriculture accounts for about one-third of GDP and more than one-half of export earnings, and remains the principal source of income in the rural areas where over 80 percent of the population live and work. The most fundamental problems Kenya faces are related to the rapid growth rate of population, currently estimated by the Government to be 3.9 percent per annum, which is among the highest in the world. This is resulting in mounting pressure on Kenya's limited arable land and food resources, inadequate employment opportunities to absorb the rising numbers of new entrants to the labor force, especially in urban areas, and increasing public expenditure requirements for basic needs. These pressures will almost certainly have a negative impact on the incidence of poverty and the pattern of income distribution. Although recent studies indicate that the pattern of income distribution in Kenya is better than previously thought, it still leaves about one quarter of the population - especially pastoralists, the landless and those living in marginal areas - below the absolute poverty line.

3. Kenya's development strategy has emphasized the promotion of economic growth through both small-holder and large-scale farming, and development of modern industries through incentives for private, including foreign, investment. The Kenyan development model can be characterized as "mixed", in the sense that it incorporates a diversity of organizational forms and incentives and combines private enterprise with a significant amount of government participation and guidance. Kenya is presently in the middle of its Fourth Development Plan, covering the years 1979-83. The Plan's basic objective is to restore growth to the levels that prevailed before 1974, while alleviating poverty through creation of income earning opportunities and the provision of social services. Particular emphasis is given to (i) the roles of agricultural growth and rural reform in poverty alleviation, (ii) the need to change the major thrust of industrial policy from import substitution to export promotion and (iii) the urgency of promoting family planning programs. In implementing these policy changes, greater importance than in the past is given to the use of market mechanisms and pricing policies, with a somewhat more limited role for Government in terms of direct participation and intervention. The Plan correctly identified the key problems that Kenya faces and sets forth a development strategy appropriate to their solution.

The Adjustment Problem

4. Kenya was able to withstand the initial pressures generated by the increases in oil prices during the mid-1970's, due to the high level of external reserves accumulated in earlier years, and an increased inflow of capital, especially from private sources. However, the balance of payments situation soon deteriorated, with slow export growth and a worsening terms of trade. The Government reacted by introducing fiscal and monetary measures to restrain both public and private consumption and channel investments to areas of immediate productive potential. These measures, together with the general world recession, slowed down Kenya's economic growth rate from an average of 6.6 percent per annum over the previous decade, to 3.7 percent in 1974 and only 1.2 percent in 1975. Although a temporary respite was provided by the coffee boom in 1976 and 1977, the situation has once again deteriorated over the past two years. Despite import restraint, the cost of imported goods and non-factor services is estimated to have risen by 25 percent in 1980, reflecting the continued sharp increases in petroleum prices and the impact of poor rains and inappropriate agricultural policies on food import requirements. As a result, the resource gap rose by more than 50 percent. Per capita incomes have fallen in both 1979 and 1980.

5. Within the framework of the First Structural Adjustment Credit, the Government has had to reassess the targets of the Fourth Plan and introduce a revised short-run economic program. It is also implementing the first steps of a trade and industry policy liberalization program as well as an upward revision of the interest rate structure. Other measures under consideration include a reduction and rationalisation of the level of protection and increased monetary incentives for export-oriented industries. However, movement on more fundamental issues - such as the exchange rate, agricultural pricing, parastatal efficiency and land use policy - has been slow. There is also an urgent need to review the tax system to reduce tax evasion and widen the limited and undiversified tax base.

6. Even with major policy changes, our projections indicate that Kenya's balance of payments situation will remain difficult for the foreseeable future. Very large external resources will be needed to support a very modest increase in per capita GDP of less than one percent per annum.

Bank Assistance

7. To date, Kenya has received 35 Bank loans, 32 IDA credits and 6 IFC investments. It also benefitted from 10 East Africa Community operations. In total, this represents a comparatively large volume of Bank Group lending, justified by Kenya's good performance and long-term creditworthiness. The Government has been responsive to Bank policy advice. We believe that this is still the case and therefore are proposing further increases in the program over the next five years.

8. Kenya's total public debt (disbursed and undisbursed) reached $3.5 billion at the end of 1980, including military debt and a notional 50% share of the debt of the East African Community Corporations. The current debt service ratio is 12.6%. Based on reasonable assumptions about the terms on which Kenya can obtain the necessary external financing, the debt service ratio is expected to rise to 19% by 1985 and to gradually decline thereafter, reaching 15% by 1990. Payments on public debt have accounted for a low and constant share of GDP (2%) in recent years but are projected to reach 6% in 1985 and decline slowly thereafter. Debt service payments to the Bank accounted for 14.5% of total debt service payments in 1980; the IDA share was 0.7%. The Bank's share of total debt service payments is forecast to rise to 15% by 1985 and to 19.5% by 1990; while IDA's share will be 1% in 1985 and 1.5% in 1990. The IBRD holds 18.5% of Kenya's debt outstanding and disbursed at the end of 1980; this ratio will rise to 21% in 1985 and is projected to remain relatively constant at 21% from 1986-1990. IDA is presently holding 11% of Kenya's public debt, but this share is forecast to increase to 15.5% in 1985 and 18% in 1990. The level of Bank exposure implied in the approved lending program, $922 million for FY82-86, must be kept under careful review since it is based on assumptions of export performance and other economic factors which may not materialise. If performance does not live up to expectation the volume of Bank lending will have to be reconsidered. To some extent, however, the expected rise in Bank exposure is due largely to anticipated repayments of loans with short-term maturities, and a gradual switch by other donors from loans to straight grants (including conversions of some loans to grants).

9. Although our lending to Kenya has been widely distributed among most of the sectors in which the Bank Group has an operational capacity, particular emphasis has been given to agriculture (33 percent of all commitments to date), transport (21 percent) and energy (10 percent). To date, about 47 percent of total commitments to Kenya, has been disbursed. Overall, project implementation performance has been satisfactory. The Bank Group has also supported Kenya's efforts at policy reform through a program loan of US$ 30 million in 1974/75 and a structural adjustment credit of US$ 55 million in 1979/80. It is expected that the focus of our lending operations in the coming years will continue to be in support of the Government's efforts to maintain a reasonable rate of growth while restructuring the economy.

To this end we intend to step up the level of structural adjustment lending, in close coordination with the IMF and bilateral donors. The IMF and the Bank have worked closely in preparing for the First Structural Adjustment Credit and the IMF Stand-by Agreement by exchanging information and views, as well as draft documents on a continuous basis. IMF missions to Kenya have also exchanged briefings with our Resident Representative in Nairobi.

10. Our recent economic and sector work on Kenya has primarily focussed on the adjustments which Kenya must make to deal with the changed international economic situation. However, the upcoming Basic Economic Report is expected to provide a more comprehensive discussion of important development issues, including income distribution, population growth, and appropriate long-term agricultural and industrial policies. Our future economic and sector work will continue to look at key structural problems in the economy to improve the analytical basis for our lending. Special attention is to be given to agriculture, both to improve project effectiveness and to provide the background for a possible shift in the focus of our structural adjustment lending towards that sector. We also hope to make greater use of Kenya's own growing and improving research institutions in the coming years.

11. The last meeting of the Consultative Group was held in May 1979, and reviewed Kenya's current economic situation and its plans for the Fourth Development Plan (1979-83). The meeting was successful in enabling the Government to exchange views with the donors and to make the case for increased aid to Kenya, as well as for a shift of resources to quick disbursing assistance. The next meeting is tentatively scheduled for June 1981.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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CONFIDENTIAL

SecM72-421

FROM: The Secretary

August 14, 1972

Pls return to me with briefing material for the 15/18 meeting with Geneva [illegible]

UNITED NATIONS ECONOMIC AND SOCIAL COUNCIL

Attached for information is a report on the fifty-third session of the UN Economic and Social Council, recently concluded in Geneva. It was prepared by the Bank's delegation.

9/5

Distribution:

- Executive Directors and Alternates
- President
- President's Council
- Executive Vice President, IFC
- Vice President, IFC
- Department Heads, Bank and IFC

SUDAN

COUNTRY PROFILE

BASIC DATA

Population		18.5 mln.
Total Growth Rate		2.9 %
Urban Growth Rate		6.8%
Age Structure		
0-14		44.1%
15-64		53.1%
Adult Literacy		20.0%
GNP Total (1979-80)	US$	4.9 bln. 1/
Per Capita	US$	265 1/
Average Nat'l Savings Rate (74-85)		8%
Investment/GDP (78-85)		15%
External Debt (1979) 2/	US$	2.2 bln.
Debt Service Ratio (FY79) 3/		18.0%
of which Bank share (FY79)		1.6%

	Lending			
	FY74-78		FY79-83	
	$ Million	No. of Operations	$ Million	No. of Operations
Total	252.7	14	531	14
Bank/IDA				
Bank/TW	32	2 4/	-	-
IDA	220.7	14 4/	531	14
% of Lending				
Agriculture	45%		46%	
Transportation	37%		20%	
Urbanization	-		-	
Water Supply	-		-	
Communication	-		-	
Energy	9%		21%	
IDF	3%		-	
Industry & Mining	-		-	
Population	-		-	
Education	4%		-	
Tech. Assistance	2%		1%	
Non-Project	-		12%	

1/ At parallel exchange rate of US$1.25=LSd
2/ Disbursed only
3/ Excludes repayment of accumulated arrears; based on amounts actually paid. On basis of amounts due ratio is about 35%.
4/ Includes blend operations.

SUDAN

Political Background

1. Despite political tensions, presently aggravated by the economic crisis, the single party system has continued to function, notwithstanding a number of abortive coup attempts. Its survival is largely due to the charismatic leadership of President Nimeiry who succeeds in keeping potential opposition in check inter alia through appointing prominent personalities, representative of existing factions, to key position, thus maintaining an adequate political balance, and through periodic cabinet reshuffles preventing the evolution of individual power bases.

2. Historically, Sudan and Egypt are closely linked and more recently Sudan has developed close relations, and a concomitant degree of economic dependence, with Saudi Arabia and the Gulf states. Sudan strongly favors a unified Arab strategy for a final solution of the Middle East conflict and Egypt's independent stand has strained relations, particularly after Egypt disclosed tentative plans for a scheme to divert Nile waters to Israel. Relations with neighboring Ethiopia became strained in the course of Ethiopia's Marxist revolution and its consequent external realignment. Sudan's role in the Eritrean secessionist conflict became a particularly sensitive issue, but relations have improved considerably and the two heads of states recently exchanged visits.

Economic Structure and Development Strategy

3. Sudan, with an area of 2.5 million square kilometers, is the largest country in Africa. Much of the country is unoccupied or very sparsely populated and there is relatively little population pressure on the land. Although a large part of the country is desert or semi-desert, the Sudan nevertheless has great untapped potential for agricultural development. About two-thirds of the total land area is suitable for crop or pastoral production, but only a small fraction of this land is under intensive use. The economy is heavily dependent on exports of cotton, the major commodity produced on irrigated land, and on groundnuts, sesame and gum arabic. The manufacturing sector is relatively small and, apart from the processing of such agricultural commodities as cotton, oil seeds and sugar, is limited to the production of consumer goods and building materials. A development of potential significance to Sudan's prospects is the discovery of oil reserves in the southwestern part of the country. Reserves proven to date are not large enough for export production; however, they are large enough to help satisfy part of the country's domestic need and a project to meet this objective is now being considered. The public sector embraces all modern irrigation facilities, the railways, virtually all power and water supply and a significant proportion of industry, commerce and finance. Although some industrial enterprises are being returned to the private sector, about half of the GDP is still generated within the public sector.

4. Sudan is in the midst of a severe economic crisis, the origins of which lie in an ambitious public investment program that began in the early 1970's. Over-commitment, combined with adverse developments in world markets, a decline in cotton production and inadequate domestic resource mobilization, led to sharply rising government deficits. Credit expansion created inflationary pressures and contributed to serious trade deficits. As a result, Sudan now has gross reserves adequate for only a few days of imports. Before the rescheduling of public debt from official sources that took place under the auspices of the Paris Club in November 1979, Sudan had somewhat over US$ 1.0 billion arrears on foreign debt service payments or well over a year of export earnings. About US$ 350 million was rescheduled under the Paris Club agreement; rescheduling of the commercial debt is now in process. The debt service ratio will exceed 40 percent of export earnings this year unless the country completes the rescheduling of debts with commercial and bilateral creditors that began last fall in London and Paris.

The Adjustment Problem

5. The current national economic crisis has forced the Government to rethink its strategy, focusing on the key short-term objective to restore economic equilibrium, particularly in the external and public sectors. Shortages of both domestic and international resources are such that expenditures need to be extremely selective, focussing essentially on investments yielding quick returns in improving the external balance. Consequently the emphasis must be on revitalization of the export sector, essentially cotton, through rehabilitation and maintenance of existing capacity, most of which is severely underutilized.

6. The Government has introduced measures aimed at economic stabilization, including substantial effective devaluation, revenue, and expenditure constraint measures. The Government also seeks to reduce its deficit financing to more manageable levels. Between 1971 and 1979, the deficit grew in nominal terms by about 40 percent per year, compared to a nominal GDP growth of about 17 percent, leading to a deficit now equal to 7 percent of GDP. Successful pursuit of this objective will aid in attaining another key objective - reducing the domestic rate of inflation, now running about 25 percent per year.

7. In June, 1978, the Government and the IMF reached agreement on elements of a stabilization program and the Fund board approved a standby facility and a First Credit Tranche drawing, totaling 51 million SDRs. In May, 1979, agreement was reached on a set of new policy actions by Government, entaling sharp restrictions on government borrowing, in order to obtain access to a three-year Extended Fund Facility for SDR 200 million. The Government, with full support from the Bank, scaled down its investment plans substantially from those in the Six-year Plan (1977/78-1982/83). The revised Three-year Public Investment Program (1978/79-1980/81) concentrates almost exclusively on the completion of on-going projects and on new projects that promise quick foreign exchange benefits. In late 1980, the IMF approved an increased quota for Sudan and also a second year program under the EFF.

Bank Assistance

8. World Bank Group commitments to Sudan to date total US$ 722.9 million. Of this, US$ 32.9 million are IFC commitments. There have been eight loans and 25 credits for a total of 29 projects. Sudan has not been creditworthy for Bank loans since the late 1960s; although two Third Window loans have been made, the last Bank loan was approved in 1968. The country is not likely to become creditworthy in the near future, unless it becomes a net oil exporter, which is not suggested by the scale of oil reserves established up to the present time. Nineteen projects are under implementation as well as one technical assistance project, funded by UNDP and executed by the Bank. About 45 percent of the total Bank/IDA lending has gone into agricultural development. Projects in other sectors include: three power projects, two education projects, two highway projects, a domestic aviation project, four railway projects, a port project, a technical assistance credit and two credits to the Industrial Bank of Sudan.

9. Physical progress in implementing development projects in Sudan has been poor, and is becoming worse as a result of the economic crisis. Many projects have difficulty in getting key materials such as cement, fuel, timber, of which there are periodic shortages. Belated delivery of equipment and supplies due to transportation difficulties also affects most projects. The continuing drain of skilled manpower from Sudan to neighboring countries, where job opportunities are better, takes its toll on effective preparation and implementation of projects.

10. During the past several years the Bank Group has been involved in an intensive dialogue with Government on its development strategy, investment program, economic policies and institutional reforms. As a consequence IDA has supported the Government's Agricultural Rehabilitation Program through a program type credit for agricultural rehabilitation and credits for rehabilitation the New Halfa, Blue Nile and White Nile irrigation projects. These credits are aimed at quickly restoring productive capacity held idle by the lack of spare parts and deferred maintenance. Major conditions involve changes in producer incentives particularly with regard to pricing and cost recovery and reorganization of the agricultural parastatal organizations. For the near term this emphasis remains the centerpiece of our assistance strategy which also finds the support of the members of the Consultative Group.

11. In addition, Bank Group lending will continue to emphasize agricultural and infrastructural investments such as the rehabilitation and intensification of existing irrigation schemes and alleviation of key infrastructure bottlenecks. The emphasis in Bank Group operations will be in support of those activities that contribute directly to the rehabilitation of the economy, in particular those that help increase exports and expand government revenues. Economic and sector work will emphasize the reforms necessary to provide incentives, improve debt management and facilitate cofinancing and aid coordination through comprehensive reporting to the

Consultative Group for the Sudan. There have been six meetings of the Consultative Group for Sudan, the last held in Paris in April, 1980. Delegations from 10 countries and 11 multilateral institutions attended. There were statements by the Bank, the Fund, Government representatives and discussions concerning the current state of the economy and future prospects; the agriculture sector and technical assistance needs in the training field. Another meeting of the Consultative Group is tentatively scheduled for late 1981.

TANZANIA

COUNTRY PROFILE

BASIC DATA

Population	17.4 mln.
Total Growth Rate	3.4 %
Urban Growth Rate	8.9 %
Age Structure	
0-14	45.7 %
15-64	51.2 %
Adult Literacy	66 %

GNP Total	US$ 4,700 mln.
Per Capita	US$ 270
Average Nat'l Savings Rate (74-85)	10.9 %
Investment/GDP (78-85)	18.9 %

External Debt (1979)	US$ 1,360 mln.
Debt Service Ratio (1979)	11.8 % (provisional)
of which Bank share (1979)	32.2 %

Lending

	FY 74-78		FY 79-83	
	$ Million	No. of Operations	$ Million	No. of Operations
Total	460.7	30	602.0	30
Bank/IDA				
Bank	210.0	12	66.0	3
IDA	250.7	18	536.0	27

% of Lending	FY 74-78	FY 79-83
Agriculture	40 %	20 %
Transportation	5 %	9 %
Urbanization	4 %	5 %
Water Supply	3 %	4 %
Communication	-	4 %
Energy	8 %	12 %
IDF	9 %	13 %
Industry & Mining	18 %	10 %
Population	-	-
Education	2 %	6 %
Tech. Assistance	1 %	2 %
Non-Project	10 %	15 %

4/14/81

TANZANIA

Political Background

1. Tanzania has experienced remarkable continuity and stability in political structure, leadership, and basic objectives since Independence. 1/ In the Arusha Declaration of 1967 and subsequent policy statements, the Government's primary objectives of socialism and self-reliance have been elaborated in considerable detail. In developing his concept of African socialism, President Nyere has stressed the themes of equity and participation, urging a broader distribution of property, government services, and income as well as the involvement of all income groups, regions, and both rural and urban areas in the development process. To accomplish these goals, the Arusha Declaration emphasized that the State should play the leading role, especially in the reform and creation of appropriate institutions. To this end, the Government has implemented a series of major policy initiatives over the past decade: the nationalization of large-scale industry, commerce and finance; the creation of numerous parastatal bodies; the formation of ujamaa (cooperative) villages; the decentralization of government (1972); and, the mass campaign of villagization (1974-76).

2. The locus of political power in Tanzania lies within the Chama Cha Mapinduzi (CCM) Party, which was granted political supremacy by the 1977 Constitution. President Nyerere is president of the CCM, and the Party's control structure is closely interwoven with that of the Government. The role of the Party in policy formulation seems to have increased in recent years, and most major policy initiatives now originate or are at least approved by the party hierarchy. This has resulted in the development of a complicated multi-layered decision making process, with, in many cases, only limited implementation functions delegated to the civil service. Partly as a result of this, insufficient attention has often been paid to technical considerations in policy formulation.

3. The latest quinquennial elections for Parliament and President were held in October 1980. Although President Nyerere was unopposed and won a "yes" vote of more than 95 percent, voter dissatisfaction was registered by the defeat of more than 50 percent of the incumbent Members of Parliament. The new Government has a number of new Ministers and Secretaries, including a new Prime Minister, Cleopa Msuya but there were no changes in the economic ministries. Shortly after the new Government was installed, an anti-corruption campaign was begun which resulted in the removal of a number of senior government officials. Combined with the continuation of a general freeze on civil service salaries which has been in effect since 1975, the campaign has led to a serious deterioration in the already low morale of the civil service.

1/ Tanganyika gained Independence in 1961 and Zanzibar in 1963. The two merged to form Tanzania in 1964.

Economic Structure and Development Strategy

4. Tanzania is one of the 30 least developed countries in the world with a per capita income in 1979 of US$ 271. The economy is still heavily dependent on agriculture which employs over 80 percent of the labor force and produces approximately 50 percent of GDP and 80 percent of export earnings. The industrial sector is still small, contributing less than 10 percent of GDP. The large and rapidly growing service sector produces about 40 percent of GDP. With a population of 17.4 million and a land area of 945,000 square kilometers, Tanzania's population density is low, although a few areas are considered over-populated. Population growth is estimated at 3.4 percent per annum, with both fertility and mortality at relatively high levels.

5. Despite the major institutional changes from Independence to the mid-1970's, Tanzania managed to achieve significant improvements in the social sectors. The enrollment rate in primary schools increased by more than 50 percent, life expectancy rose by almost five years, and access to safe water improved in both rural and urban areas. There was also satisfactory progress on the general macro-economic indicators: real GDP grew by 4.4 percent per annum from 1966 to 1973, and the gross investment rate rose to above 20 percent. But this economic record was blotted somewhat by the relatively slow growth of the productive sectors in the economy particularly agriculture and the poor rate of return on new investment. As regards the objective of self-reliance, although Tanzania made rapid progress towards "citizenization" of the economy, large gaps in manpower requirements remained. And the dependence on foreign aid to finance both domestic investment and the widening balance of payments gap increased.

The Adjustment Problem

6. Since the mid-1970's the Tanzanian economy has come under severe strain: (i) GDP per capita in real terms is estimated to have risen by only 0.7 percent per annum since 1973; (ii) despite severe import restraint and the availability of substantial amounts of foreign assistance, the balance of payments situation has become critical, with net external reserves having fallen as low as minus US$ 286 million by the end of 1980; and (iii) the budget deficit and domestic bank borrowing have risen sharply since 1978/79, resulting in rapid money supply growth and domestic inflation. Undoubtedly, a series of adverse external events - including the oil price rises since 1974, the collapse of the East African Community in early 1977, the war with Uganda in 1978-79, and in 1980, another year of poor rains - have further aggravated the existing problems and made more urgent the need for restructuring the economy. But the underlying weaknesses are of a more long-term nature and related primarily to the structure and performance of the domestic economy. These include declining export volumes (they are now one-third lower than in 1973), disappointing growth in the monetized and productive sectors, and poor maintenance and utilization of existing capital stock. In agriculture, the problems have been compounded by longer-term developments in government strategy. The importance attached to rural development in government pronouncements has not always been fully reflected in the allocation of resources to the agricultural sector or

in policy formulation and implementation. Also, many of the institutional changes in the sector were introduced too rapidly, without careful planning or sufficient recognition that by themselves they could not compensate for inadequate incentives and shortages of skilled manpower and managers.

7. While the seriousness of the economic situation has been apparent for some time, the Government has been slow to respond. Except for further restrictions in imports and public maintenance and operating expenditure, little has been done to compensate for and minimize the adverse consequences of external events. Indeed, in some areas, difficulties have been aggravated, by continuing to expand government involvement and control of the economy without due regard to the limited financial and administrative capacity available.

8. After very protracted negotiations, the IMF approved on September 15, 1980, a Standby Arrangement for Tanzania, which was to provide up to US$ 235 million over the next two years (an additional US$ 20 million was drawn under the Compensatory Financing Facility). However, for a variety of reasons, Tanzania was unable to meet the program's ceilings for external arrears, government borrowing and domestic credit. As a result, drawings were suspended in December 1980. Although the Government has subsequently taken additional revenue measures to improve the fiscal situation, the extent to which the ceilings have been broken is so large that it is not considered possible to restore drawing rights under the existing program. The IMF has, therefore, sent a further mission to Dar es Salaam (arriving April 1, 1981) and it is hoped to agree on a broader program for restructuring the economy, to be supported by an extended arrangement with possibly larger resources from the Fund.

9. More basic and comprehensive policy adjustments will be required to see Tanzania through the difficult two to three years ahead and eventually restore balance in the economy. Issues still to be addressed include: formulation of an effective strategy towards agricultural development, with particular emphasis on improving productive efficiency through better incentives, input supplies and research and extension systems; improved organization and operational efficiency of the parastatal sector; greater budgetary provisions for operations and maintenance, especially in agriculture and the supporting processing and transport infrastructure; a re-evaluation of development projects, to ensure that they are of high priority and compatible with the present constraints; and a general improvement in governmental budgetary control and planning capacity. Unless such a program is implemented and supported by additional concessional financing from the international community, Tanzania will find it increasingly difficult to make progress towards its economic and social objectives. The Export Rehabilitation Credit proposed for consideration by the Board in late April 1981 is intended to help Tanzania begin implementation of such a program.

Bank Assistance

10. To date, 47 IDA credits and 19 Bank loans, amounting to US$ 899.3 million, have been approved for Tanzania. In addition, Tanzania has been a beneficiary of 10 loans totalling US$ 244.8 million which were extended for the development of the common services and development bank operated regionally by Tanzania, Kenya and Uganda through their association in the East African Community. However, because of Tanzania's present economic difficulties, all Bank Group commitments since mid-1979 have been on IDA terms. Commitments held by IFC in Tanzania how total US$ 3.2 million (after cancellations).

11. Owing to the very concessional terms on which past aid has been given to Tanzania and the Government's previous reluctance to use higher cost commercial loans and suppliers' credits, the country's overall debt service ratio has historically been less than 10 percent. However, the debt service burden is expected to increase as past loans fall due for repayment and new borrowings, including some on commercial terms, are required to meet the widening balance of payments gap. Such borrowings, together with very poor export prospects, could raise the debt service ratio to 15-20 percent during the 1980s.

12. In support of Tanzania's overall development strategy, Bank Group lending operations have assisted a wide spectrum of activities with emphasis on agriculture (30 percent), industry (25 percent), energy (12 percent), transport and communications (11 percent), and education (5 percent). Two program credits/loans totalling US$ 45.0 million have also been provided to Tanzania.

13. At present about one-half of all Bank Group loans and credits remain undisbursed. Although this high proportion is in part due to recent signing of agreements, it also reflects mounting problems in project implementation caused by manpower shortages, frequent and fundamental administrative changes, and critical shortages of essential goods and services. Until the general economic situation improves, the outlook is for continued and sometimes unforeseen delays in project disbursements.

14. With the present foreign exchange crisis, and the need to divert a larger share of resources towards operations and maintenance, the Bank proposes to sharply increase the amount of program and structural adjustment lending in future years, provided the Government is willing and able to implement policy changes designed to restore incentives for production and exports, and reduce the role of the public sector or make it function efficiently. It will also be necessary to carefully review all on-going projects, to stop or cut back projects which place an undue burden on the limited financial and manpower resources available. The present lending program calls for an increase in lending to over US$ 600 million during the five years FY81-85, but with an appropriate response from the Government, a larger program could be justified.

15. The latest country economic memorandum for Tanzania was distributed in January 1981. This, together with our on-going preparation of the proposed export rehabilitation credit, has highlighted the need for more economic and sector work in support of our lending operations and geared to the immediate issues of rehabilitation and restructuring. Over the three years FY81-83, we plan to devote more than 460 manweeks to economic work, with particular emphasis on the agricultural sector.

16. The last Consultative Group for Tanzania (and the only one since the breakup of the EAC) was held in May 1977. We have recently been discussing with the Government the possibility of a further Consultative Group meeting in the near future, to build on the program developed for the Export Rehabilitation Credit and to provide additional resources for the proposed Agricultural Account. The Government has expressed some concern that in the present aid climate, it might be better to wait until a more comprehensive structural adjustment program is in place (perhaps towards the end of 1981) and, at their request, we are presently exploring the various options with the donor community.

ZAIRE

COUNTRY PROFILE

BASIC DATA

Population 1/		26.8 mln.
Total Growth Rate		2.7%
Urban Growth Rate		7.7%
Age Structure		
0-14		45.5%
15-64		52.7%
Adult Literacy		15.0%
GNP Total		6,968 mln.
Per Capita	US$	260
Average Nat'l Savings Rate (78)		19.7%
Investment/GD) (78)		15.3%
External Debt (1979)	US$	4,583.4 mln.
Debt Service Ratio (1979)		26.0%
of which Bank share (1979)		7.4%

	Lending			
	FY 74-78		FY 79-83	
	$ Million	No. of Operations	$ Million	No. of Operations
Total	238.0	10	219.5	15
Bank/IDA				
Bank	100.0	1	-	-
IDA	138.0	9	219.5	15
% of Lending 2/				
Agriculture	14.1%		22.8%	
Transportation	21.8%		33.2%	
Urbanization	-		-	
Water Supply	9.0%		4.6%	
Communication	-		-	
Energy	-		3.2%	
IDF	4.2%		12.9%	
Industry & Mining	42.0%		22.8%	
Population	-		-	
Education	8.8%		-	
Tech. Assistance	-		0.5%	
Non-Project	-		-	

1/ Data refer to any year between 1974 and 1978; most recent data for GNP (and per capita GNP) is for 1979.

2/ Because of rounding the totals may not add up to 100%.

ZAIRE

Political Background

1. Independence gained from Belgium in 1960 was followed by a period of instability and internal strife until the end of 1965, when General Mobutu assumed power. Overall, the internal situation has remained calm since, despite the invasions of Shaba in 1977 and 1978. Externally, Zaire has successfully pursued a policy of good relations with its neighbors including Angola and Zambia. The President has very broad powers including those to pass legislation; he names the members of the Political Bureau of the Mouvement Populaire de la Revolution (MPR), the sole political party. The National Assembly (Legislative Council) is an arm of the MPR, whose members are elected by universal suffrage. The latest Cabinet change (August 1980) brought back Mr. Karl-I-Bond as Prime Minister 1/ and Mr. Sambwa as Governor of the Central Bank. These changes, together with the appointment of Mr. Namwisi as Finance Minister earlier this year, place competent people - who enjoy a good reputation abroad - at the helm of the Zairian economy. The new cabinet is likely to be more amenable to the policies of restraint and liberalization recommended by the IMF than its predecessor. We therefore expect our dialogue with the Government to be more fruitful than in the past.

Economic Structure and Development Strategy

2. Zaire is the third largest country in Africa in terms of area and the fifth largest in terms of population (27 million), but its per capita GNP, at about $260 in 1979, ranks among the lowest in the continent. Although agriculture, commercialized and subsistence, accounts for less than 20 percent of GDP, it provides livelihood to more than three-quarters of the population; main foodcrops are manioc and maize, while coffee and palm oil rank first in commercial crops, followed by cotton. Mining is the foremost economic activity; Zaire is the world's largest producer of cobalt (60 percent of world's production) and industrial diamonds, and the seventh largest producer of copper. The mining and mineral processing industry accounts for about 20 percent of GDP; it has been traditionally the largest source of public revenue and provides about 70 percent of the country's export earnings. Because of its size, topography and virtually land-locked position, Zaire's economy is crucially dependent on the internal transport network of rivers, rail and roads.

3. Following the restoration of political order in 1967, GDP grew by about 7 percent per year in real terms until 1974. Since then, however, Zaire has experienced serious economic difficulties which have brought about a continuous decline in aggregate output. Several factors contributed to the crisis, most notably (i) the deterioration of the terms of trade, in particular the fall in the international price of copper; (ii) heavy external borrowing (totalling more than $2.0 billion in 1973-74 alone) at average terms inconsistent with the country's level of development and for projects with delayed or uncertain economic benefits and (iii) the disruption of economic activity by the nationalization measures of 1973-74. Between 1975

1/ Recently the Prime Minister has offered his resignation.

and 1979, GDP contracted on average by 3.5 percent per year due to the acute shortage of foreign exchange and hence inputs. Inflation fueled by deficit financing ran high and arrears on the repayment of external debts accumulated to about $1.8 billion.

4. Over the past 18 months, the Government has made serious efforts to arrest the contraction of the economy and prepare the conditions for recovery. In March 1979, a stabilization program was adopted, with the support of a standby arrangement with the IMF, the criteria for which have been so far substantially met; some short-term external assistance has been mobilized through several donors' meetings; and the external debt with both private banks and the Paris Club has been rescheduled and the new terms respected. Also a number of measures have been taken to improve economic management. The Zaire currency was devalued in several steps by about 75 percent as compared to end 1978; a three year investment program has been prepared (with some assistance from the Bank); efforts to increase fiscal revenues and to curtail expenditures have brought inflation down from about 100 percent in 1979 to about 47 percent in 1980; a number of institutions, notably the Central Bank, the Ministry of Finances and the Customs office have been strengthened and a Central Pay Directorate created by expatriate technical assistance teams under the aegis of international organizations or bilateral donors; and a number of policy measures have been implemented to increase producer prices and improve the allocation of foreign exchange.

5. On the strength of that experience, the IMF and Zaire have begun to negotiate an EFF in support of a three-year recovery program. It is expected that this EFF will be presented to the Board of the IMF in June 1981. We have cooperated closely with the IMF on Zaire, particularly in the last two years, along traditional institutional lines, with the IMF focusing on short-term policies and their monitoring, and the Bank advising the IMF on structural and sectoral problems of a longer-term nature. With the recent redirection of IMF focus toward supply-oriented policies, our cooperation has increased even more. Zaire's situation is still precarious and will require constant monitoring.

<u>The Adjustment Problem</u>

6. The economy remained in difficulty in 1980 largely because of the unprecedented volume of external debt payments due (more than $400 million, or two-and-a-half times the amount of 1979). The outlook for 1981 is mixed, with huge requirements to rehabilitate infrastructure and productive capacity contrasting with declining prices of mining products, in particular cobalt. This situation and the necessary steps to redress it were reviewed at a Consultative Group meeting in May 1980; the participants agreed to the need for more assistance but insisted on further improvements in Government policies. If the IMF's EFF loan is agreed, the prospects for an extensive debt rescheduling in the Spring of 1981 are good. However, setting

the Zairian economy on the path of recovery would require (i) a further debt rescheduling bringing the service of the debt to a manageable level; (ii) the adoption by the Government of a comprehensive and coherent supply policy package to stimulate the resumption of external confidence; and (iii) substantial financial assistance from the international community to replenish a badly depleted project pipeline and restore capacity utilization. Our work in the next few months will aim at defining the role which the Bank should play in the context of both a supplier of financial and technical assistance and a catalyst of external aid.

Bank Assistance

7. To date, the Bank Group has committed almost $400 million in project aid in Zaire. With the exception of a large Bank loan for an enclave project in the mining sector, all lending has been on IDA terms. This assistance has enabled Zaire to mobilize substantial co-financing, particularly for mining and transport projects. However, it is still at a low level for a country of this size, and a much higher level of commitments would be possible if performance and creditworthiness improves. The creditworthiness of Zaire has been very low in recent years--one of the lowest among developing countries--largely because of the accumulation of vast external debt arrears (US$1.8 billion at end-1979) and low external confidence in the country's Management. In 1980, Zaire's creditworthiness improved as a result of the successful implementation of the stabilization program, supported by the IMF, and the rescheduling agreements concluded with the members of the Paris Club and the syndicated private banks, which have been substantially respected to date. The reopening of private credits is,nevertheless, still slow and will be crucial to the country's recovery. Further changes in institutions and policies--and time--will be needed to restore Zaire's creditworthiness to its pre 1975 level.

8. A close dialogue has been established with the authorities on economic and sector issues and in helping to coordinate external assistance. Project implementation has been uneven, most difficulties stemming from uncertain Government priorities, administrative weaknesses and acute lack of foreign exchange; the best record lies in those sectors where reasonably effective institutions exist, e.g. Transport, Mining, Development Bank. Our current strategy consists of helping to rehabilitate, and develop infrastructure to support recovery of the productive sectors, mining, agriculture, and industry. We consider Transport as the highest priority since it is vital to haul out mining production and to distribute essential inputs and other goods in the interior. We are also giving high priority to agriculture, where self-sufficiency should be restored both to alleviate balance of payment pressures and to generate other activities. Another major objective is the maintenance and development of Gecamines, the country's major mining company and largest single foreign exchange earner. In the medium-term, there is a risk that too severe financial conditions imposed on Gecamines in the framework of stabilization and external debt repayment policies, might damage its capacity and hence constitute a threat to future recovery. We have received a request from the Government to help put together a financing package of $160 million for Gecamines and will soon initiate discussions with the authorities on the conditions at which we could participate in such financing with other co-financiers.

9. Structural adjustment and/or program lending is premature for Zaire. With the external current account balance nearly in equilibrium due to the low level of activity, such lending would be tantamount to providing resources to repay debts. We propose instead to continue to support priority investments in key sectors.

10. We also consider that our lending must be complemented by a high level of carefully focused technical assistance, primarily on macro-economic issues, aid coordination and medium-term planning as in the past, but also on sector strategies and selected institutional problems.

11. Our current lending program for FY82-86 averages four projects and less than $48 million per year, i.e. $1.75 per capita per annum. Because a measure of improvement in economic management has taken place over the past 18 months, we could now consider a modest increase, in line with the still limited absorptive capacity of the country.

12. The Consultative Group for Zaire, which met last in May 1980, has played a useful role as a forum for the exchange of ideas on Zaire's economic situation and prospects and for drawing the attention of both Zaire and the major donors to the priorities for action, e.g., debt rescheduling, agricultural policy, improved economic management, etc. The CG is the only international forum for addressing Zaire's problems and needs in their totality and in an integrated manner. It has proved to be a very useful tool for this purpose.

West Africa

Country Statements

COUNTRY PROFILE: NIGERIA

Outline:		Lending (in $ millions)			
		FY76-80	FY80	FY82	FY81-85
Population: 83 million					
GNP per capita (1979): $750*	Bank	620.3	286.3	317.0	2,300.0
	IDA	-	-	-	-
External debt: $3.3 billion (1979) (disbursed only)					
		Number of Operations			
Debt service ratio: 1.6% (1979)	Bank	14	5	5	26
of which Bank Group: 18.3% (1979)	IDA	-	-	-	-

* estimate based on the 1978 level (US$670), a growth rate of population of 2.6%, and a growth rate of GNP in current prices of 15%.

Political context

1. Since the attainment of national independence in 1960, Nigeria has experienced a turbulent political history. The assassination of the first Prime Minister (Sir Abubakar Tafawa Balewa) in 1966 heralded a three-year civil war in which the Ibos of South Eastern Nigeria attempted unsuccessfully to establish their own state of Biafra. At the same time the government passed into the hands of the military which continued to exercise political power for thirteen years until October 1979.

2. It is to Nigeria's credit that a process of national reconciliation was instituted both quickly and successfully after the end of the civil war in 1970. It is also a measure of Nigeria's relative political sophistication that the reins of government were handed back to civilian control in a planned and orderly fashion nine years later.

3. The new civil constitution that was introduced in 1979 is based on the USA model, but incorporates an intricate array of checks and balances that are designed to diffuse the intense regional and tribal rivalries that still prevail between the Yoruba of the South West, the Ibo of the South East and the Hausa of the North. The decision to build a new federal capital at Abuja, close to the geographical center of the country, also reflects a sensitivity for the need to balance regional interests.

4. In the elections of 1979, the National Party of Nigeria (NPN) emerged with the greatest and widest support and its leader (Shehu Shagari) was elected President. The NPN does not enjoy an absolute majority in the National Assembly, however, and must rely upon support from other parties to

enact its legislative program. Furthermore, the NPN controls only seven of the nineteen state governments which underscores the fragmented nature of the body politic. The extent to which the government will be successful in implementing its ambitious development program will depend, therefore, upon the success with which it can create a sense of unity and cooperation between the various groups within the country at a political level.

Resource Position and Prospects

5. One of Nigeria's most notable features is its substantial oil and gas resources. At present, the oil income amounts close to $300 per head, or about 35 percent of income per capita. .Daily output of oil has averaged over two million barrels over the past several years and, barring short-term market fluctuations, it is expected to be sustained at that level throughout the 1980s. Domestic oil consumption has been rising rapidly (over 15 percent a year), with little likelihood of it significantly slowing down in the coming years. Whereas Nigeria currently exports over 90 percent of its petroleum production, the exportable surplus may decline to 70 percent by 1990.

6. While the dramatic rise in the oil income during the 1970s eased the foreign exchange and fiscal position of the country, it also brought in its wake a number of problems of both short and long-term nature. The oil boom of 1973/74 resulted in rapidly rising imports, construction and other service activity so that the economy began experiencing acute bottlenecks in ports, highways, power and communication sectors. Expenditures rose so rapidly that large deficits in government budget and balance of payments soon reappeared, leading the country to the brink of a serious financial crisis in 1978. The government managed these problems with remarkable resolution and firmness. While the turnaround in the financial situation can be attributed largely to successive increases in the oil price of 1979 and 1980, it can be fairly said that the fiscal and import restraints that the government had instituted in 1977 and 1978 were likely by themselves to ease considerably the financial problems of the country in the years ahead.

7. The above developments understandably took the center-stage of economic policy, but the oil boom also generated impulses--not clearly perceptible at the time--which tended to militate against the objectives of long-term economic growth. Basically, the sudden accrual of the large oil income moved relative prices (exchange rate, relative sectoral costs) in such a manner that domestic agriculture as well as manufacturing was put at a distinct disadvantage vis-á-vis both foreign produced goods (which became relatively cheaper) and domestic construction and service sectors (which became more lucrative). The result was that the growth was concentrated in construction, trade, commerce and other services, while domestic agriculture and manufacturing failed to meet the rising demand. These developments tended to weaken the economic basis for future growth and increased the economy's dependence on oil, even though the great bulk of the oil income was invested in non-oil sectors.

8. Although the recent round of oil price increases has made Nigeria's financial situation once again quite comfortable, it is also liable to perpetuate, if not worsen, the structural distortions in the economy. In order to provide a basis for the long-term growth of the Nigerian economy, the dependence on oil must decline as the resource is depleted. This would entail ensuring that the pattern and rate of growth of domestic agriculture and manufacturing is such that domestic production over time comes to replace imports and adds to non-oil export earnings. Unless there are substantial new oil finds, the chances for which are not very high, oil output may begin to decline slowly in the 1990s. Exports of natural gas from the proposed LNG project (with a capacity to liquify 2 billion cubic feet of gas a day) are not expected to make up for the decline in the oil exports. It seems that Nigeria has essentially ten years to bring about the required structural adjustment.

9. While the government appears deeply concerned about stimulating the growth of agriculture and industry, we do not think that it has so far really confronted the issues involved in any systematic manner. The government can be given credit for realizing the importance of agriculture and making it the main pillar of the strategy in the Fourth National Development Plan period (1981-85), and for resisting the pressures to abandon financial discipline. The government appears to be conscious of the experience of the 1970s, and intends to keep the investment program manageable. It views the Fourth Plan period as one of consolidation, and while public investment will remain large, there will only be a small increase in real terms over the estimated level during the Third Plan. What remains to be seen is whether the development strategy embodied in the Plan will effectively reduce Nigeria's dependence on oil revenues.

10. The absorptive capacity of the economy and the government's ability to manage a vast investment program has remained another important development issue. The fact that public investment quadrupled in a relatively short period of time was bound to strain the administrative capacity. In fact, during the preparation of the Third Plan (1975-80), the government had anticipated this problem. Well before the Plan was launched, a Public Service Review Commission (the so-called Udoji Commission) was established to suggest ways and means for improving the Nigerian civil service. In a desire to move quickly and overcome the administrative constraints, the government also relaxed for the Third Plan the procedures for selection and execution of projects. Specifically, regulations governing competitive tendering and prior appraisal of projects were moderated. Also, a number of projects were given to foreign contractors on a turn-key basis. Consequently although many infrastructure projects were speedily completed, the project costs turned out to be far higher than those in other countries. Investments in primary education, the focus of the government efforts, were severely handicapped by the shortage of teachers.

Economic Policy Dialogue

11. The central issue in our policy dialogue with the Government is how Nigeria can best exploit the opportunity for economic progress offered by its oil resources. Over the past three years extensive economic and sector work

program has been mounted both to improve our policy dialogue and to back up our lending operations. The result has been that our policy dialogue has improved in depth as well as in mutual understanding. There are indications that the government values Bank help in such critical areas as preparation of food plan, setting up a separate planning organization, and instituting performance budgeting.

Bank Lending to Nigeria

12. The Bank's operational relationship with Nigeria has undergone a radical transformation during the last several years. In the period that followed the oil boom of 1974, the Government devoted its full energies to pursuing the ambitious targets of the Third National Development which was predicated upon the assumption that Nigeria would remain a capital surplus country throughout the Plan period and beyond. Being eager to achieve physical planning targets within a short time span, many public sector agencies were unwilling to submit their projects to rigorous appraisal and contracting procedures, and in those circumstances there was little scope for Bank lending. The only sector in which the Bank was able to sustain an active program during the mid-seventies was agriculture. Although our lending even there fell short of our targets by a significant margin, the Bank was able to contribute significantly to agricultural development.

13. A turning point in relations between the Bank and Nigeria came late in 1976 by which time it was already clear to the Government that the overall balance of payments was moving into deficit and Nigeria would have to borrow abroad in order to finance its development program. The Bank responded positively to representations from the Government for a substantial increase in the volume of lending and a pipeline of projects was built up with remarkable speed. In FY1979, lending amounted to US$182 million compared with an average of only US$81 million during the preceding four years and the currently approved five-year lending program calls for lending to be increased to an annual average of US$460 million. Recently, the Nigerian authorities have asked that this target lending program be expanded still further. Insomuch as an annual progam of US$460 million will amount to less than US$6 per capita, it would be consistent with average Bank lending to other countries in the same income bracket as Nigeria. However, the Government is already committed to a very large investment program that places a heavy burden upon its limited administrative, managerial and technical manpower resources. Any increase in Bank lending over and above the level currently envisaged would have to be assessed against the constraints of absorptive capacity.

14. Given the recent increases in oil prices, it seems likely that Nigeria's overall external account will be in surplus during the coming several years, although it is projected to move into deficit again by the late 1980s. The case for continued Bank lending over the next few years, therefore, does not rest upon the need for resource transfer but rather upon Nigeria's low level of development, its importance within the overall African context and the demonstrated effectiveness with which the Bank is able to contribute positively to the development effort. To that end, our principal objective

will be to assist the Government in accelerating the vital process of structural change. More specifically, our lending objectives are (i) to increase the absorptive capacity of the economy; (ii) to reduce the economy's dependence on oil by supporting the commodity producing sectors, in particular agriculture; and (iii) to strengthen the Government's effort towards poverty alleviation. The strategy towards meeting these objectives has several elements which may be summarized briefly: first, as development of agriculture is central to both poverty alleviation and economic diversification, we propose to direct a major share of our resources to this sector; secondly, we propose a considerable expansion of our lending to meeting other aspects of basic human needs; thirdly, in all projects our aim will be to improve the quality of resources management by the Government. Finally, high priority will be given to supporting appropriate changes in the macro-economic and sectoral policy framework, through our lending operations as well as through an intensive economic dialogue with the Government.

WAIA
March 31, 1981

COUNTRY PROFILE: GHANA

		Lending (in $ millions)			
Population: 11.3 m		FY76-80	FY80	FY82	FY81-85
GNP per capita (1979): $400	Bank	114.5	-	-	-
	IDA	92.5	54.5	43.0	300.0
External debt: $855 million					
		Number of Operations			
Debt service ratio: 4%	Bank	7	-	-	-
of which Bank Group 1.16%	IDA	3	2	4	13

1. Ghana is relatively well endowed with natural resources - minerals (gold, bauxite, diamonds, manganese), timber, cocoa, hydro-energy and some petroleum. Its dismal economic performance has been due primarily to poor economic management. The country was set on the wrong track by Nkrumah's grandiose industrialization program and socialist economic ideology. The legacy of problems which successive governments have failed to tackle includes:

a) structural weaknesses in the balance of payments reflecting neglect of agriculture (mainly cocoa) and import intensive patterns of industrial production;

b) a system of import controls, depleted foreign exchange reserves and chronically over-valued currency;

c) an overgrown and inefficient public sector which drains the budget and diverts resources from productive investment; and

d) a large overhang of foreign debt.

Ghana's problems have been compounded by political instability and frequent military intervention. The country has experienced seven different governments, including four military take-overs, since independence in 1957.

The Performance Record

2. Economic performance over last decade has been poor. The features of this poor performance include:

a) No Growth - From 1974 to 1979 real GDP declined at annual average rate 1.1 percent resulting in declining per capita income of about 4.0 percent per annum, and with little signs of recovery in 1980.

b) Declining Exports - Cocoa output (cocoa accounts for 80% of country's foreign exchange earnings and nearly 50% of government revenues) declined to 265,000 tons in 1978/9 compared with over 400,000 tons in the early 1970s. The main causes have been low producer price, inadequate rehabilitation efforts and shortages of imported inputs. Minerals exports have also been stagnating.

c) Inflation - This has been caused mainly by rapid growth in budget current expenditures, slow growth in public revenues, widening budget deficit and expansion in money supply. Inflation reached 116% in 1977.

d) Overvalued Exchange Rate - Spiralling inflation, no production increases, acute foreign exchange shortage, all resulted in a greatly over-valued exchange rate. The distorted exchange rate acts as heavy disincentive to exports, encourages smuggling and losses to official reserves, and has adverse implications for Government revenues.

e) Short-Term Debt Arrears - Depleted foreign exchange reserves resulted in build-up of short-term external debt arrears from $245 million in 1977 to $489 million end-1978.

Stabilization Efforts and Current Position

3. In mid-1978, the newly installed Akuffo military Government initiated a stabilization program which included a 58% devaluation, tough budget, curtailment in money supply growth and partial demonetization of cash in circulation. The inflation rate declined to 73% in 1978, 54% in 1979 and 39% first seven months 1980. However, Akuffo was ousted by the Rawlings' coup in mid-1979 before the stabilization program could be fully carried through. A new elected civilian government was installed in November 1979.

4. The new Government is still fragile, with a slim majority; and the threat of military intervention remains. The country's assets are in a state of disrepair in almost every sector following a decade of neglect. A major rehabilitation effort is required, but there are acute shortages of spare parts and raw materials due to foreign exchange scarcity. The Government administration and public sector bureaucracy are in disarray, and demoralized in the aftermath of military rule. The Government faces a dilemma. On the one hand, it must come to grips with problems and institute major economic reform programs or it will lose credibility. On the other, the Government fears that a major reform program, including devaluation, may bring back the military.

Economic Reform Program

5. In the Bank's economic dialogue with Government we have pushed for a number of reforms including:

a) Production Incentives The currency is still greatly over-valued; the black market rate of 26 Cedis to the Dollar compares with official rate ₵2.75 = US$1.0. A devaluation is essential to create incentives for export sectors (mining, timber, cocoa), reduce smuggling, and permit efficient pricing of foreign exchange resources for imports. Without a flexible exchange rate policy it would be difficult to set and maintain cocoa producer price at incentive levels. (Every ₵10 increase in producer price costs about ₵10 million to the budget). The Government is concerned about the domestic price effect of devaluation, but the dominant concern is political and fear of Government's fall. However, the exchange rate issue is under study by Government, including some form of indirect action, e.g. special exchange rate for export sectors.

b) Domestic Resource Mobilization - The public savings record has been poor and the Government revenues to GDP declined from 15% in 1974/5 to 10% in 1978 due to tax evasion, poor collections, shrinking tax base, operating losses of State enterprises and declining cocoa exports. A recent Bank study on domestic resource mobilization was well received by Government. Revenue raising measures are under consideration by Government for June 1981 budget.

c) Public Investment Program - Government has been very slow to formulate a medium-term investment program reflecting investment priorities within the situation of tightly constrained domestic and foreign resources. Work is under way and is scheduled to be completed by end-March.

d) Short-Term Stabilization - Short-term economic stability is a prerequisite for sustained economic growth and development. Negotiations for Standby Arrangement with IMF have dragged out with exchange rate being the main stumbling block. IMF would consider some "up-front" release of funds without action on exchange rate provided they have a clear prior understanding with the Government on timing of future action. The most recent indications are that pressures are again building up on the budget, export sectors are facing an increasingly critical situation, smuggling has been increasing and acute shortages persist. The Government is likely to be forced to take more far-reaching measures to contain the critical situation, including substantial direct or indirect devaluation, around mid-year 1981, probably in context of Budget for FY82.

Bank Strategy and Operations

6. From March 1977 to May 1979, there was no new Bank Group lending to Ghana because of the deteriorating economic situation. Lending was resumed in mid-1979 on a limited basis following the stabilization efforts under Akuffo. The Bank lending strategy was to provide limited support at the sectoral level where individual projects continue to make economic sense and to underpin our

economic dialogue with government as it gradually comes to grips with the country's problems. Government has had unrealistically high expectations of what Bank Group and other aid agencies could and should do by way of assistance to Ghana. More recently, there has been a greater realization that foreign exchange alone will not solve the country's problems and that there is a need for an economic reform program.

7. If government moves forward with acceptable policy package - action on the exchange rate, increased cocoa producer price, revenue raising measures and public investment program - the Bank should move forward quickly with a program or structural adjustment lending operation. Such a program is likely also to justify IMF support under an Extended Fund Facility. A Ghana Consultative Group might be reconvened to coordinate the assistance package and economic development programs. Expanded Bank group lending program might then be justified including increased use of sector loans (e.g. highways, cocoa). Successful implementation of economic reform program might also justify resumption of limited amount of Bank lending in addition to IDA Credits.

WA1DB
March 23, 1981

COUNTRY PROFILES: UPPER VOLTA

1979		Lending (in $ millions) FY76-80	FY80	FY82	FY81-85	
Population: 5.6 million						
GNP per capita: $180						
External debt: US$404.8 million	IDA	85.4	35.0	58.1	247	Commitments
		63.7	15.0	-	-	Disbursed
Debt service ratio: 3.8%						
of which Bank Group: 4.8%		Number of Operations				
(As share of total debt service)	IDA	9	3	4	13	

1. Upper Volta is landlocked in the center of West Africa, more than 600 km from ports on the Gulf of Guinea. The country is about half the size of France, with 70 percent of its area suitable for agriculture or herding. Rainfall and soil quality vary considerably through the country's three major ecological zones: the Sahelian zone in the North, where rainfall averages less than 600 mm annually; the central plateau, located in a drought-prone belt of 600-900 mm rainfall with relatively infertile, shallow soils; and the Sudano-Guinean region in the southwest, which is favored by a longer and more stable rainy season, richer soils, and water resources suitable for irrigation. Some 60 percent of the population remains concentrated in the central plateau, which contains only 34 percent of the country's arable land, although resettlement to the more fertile southwest has increased as these areas have become cleared of riverblindness.

Past Performance

2. The main constraint to development of the Voltaic economy is its extremely limited base of human and physical resources. The lack of educated manpower is illustrated by Upper Volta's literacy rate of 5 percent, versus 38 percent for a comparable group of low income countries. 1/ The country's weak endowment of physical resources is worsened by the progressive overexploitation and erosion of soils; sharp annual fluctuations in rainfall; and high costs of exploiting the few mineral deposits (primarily manganese and rock phosphates) which do exist. The steady emigration of the better-educated, youthful labor force to neighboring countries has provided a significant opportunity for raising the incomes of some individuals despite Upper Volta's own limited resources, although loss of the most able workers may also restrict the rate of innovation and growth which can be achieved in the domestic economy.

1/ World Development Indicators, 1980.

3. Agriculture and livestock constitute a livelihood for over 80 percent of the population and account for 40 percent of GDP and 90 percent of total exports. Except in areas of the southwest where cotton, the main export crop, is grown, farming is predominantly subsistence-oriented; however, the country manages to feed itself in years of normal rainfall. Since production per capita varies widely among regions, the timely distribution of cereals stocks to deficit areas is the major food supply issue. Imports, which comprise mainly manufactured goods, have grown more than twice as fast as exports throughout the past decade, which has resulted in a trade deficit averaging about 30 percent of GDP in recent years (as compared to about 20 percent for Mali and 7 percent for Niger, for example). Despite substantial inflows of workers' remittances and concessional foreign aid, Upper Volta's annual current account deficit has risen to 6-10 percent of GDP since 1975.

4. In spite of a favorable environment of domestic economic policies and foreign aid and a high level of investment (one-fourth of GDP), growth of national income has only marginally exceeded the increase in population over the past two decades, reflecting the binding constraint of resources besides capital and the economy's continued vulnerability to climatic variation.

Politics

5. Upper Volta has had a civilian-elected government for twelve of the twenty years since independence, broken by three periods of military control. The most recent military takeover, in November 1980, occurred after prolonged and widespread work stoppages by the country's powerful trade unions. Despite the numerous changes of regime, Upper Volta's policy makers have consistently demonstrated an egalitarian orientation, a genuine concern for development, particularly of the rural sector, and receptiveness to external assistance and advice.

6. The cyclical shifts between civilian and military rule have been paralleled by an alternate pattern of relatively loose financial management and tighter budgetary control. Under the most recent elected government, Upper Volta's overall Treasury balance deteriorated from a net surplus inherited from the military administration in 1974 to a deficit amounting to 3.8 percent of GDP in 1979. Although the sources of this widening deficit include increased spending on public sector salaries and, ironically, on defense, the worsening financial account reflects not so much specific expenditure excesses or lax revenue collection by the civilian government as the absence of procedures of financial planning and accountability which could maintain order and control under the pressures of a democratic administration. One of the most serious problems, for example, is that the government has committed itself to investments with little analysis of the economic justifiability of projects, their impact on the recurrent budget, or their relative priority given development objectives and financial limitations. The Ministries of Planning and Finance under the former regime requested Bank assistance in establishing an investment fund, or budget, as a means of improving the coordination and programming of investment decisions, and the new administration has endorsed this request. Bank missions are scheduled to visit Upper Volta in April to appraise a technical assistance project which would help set up the new system, and to respond to an additional Government appeal for advice on macroeconomic policy.

Options for the Future

7. Because of Upper Volta's severe resource constraints, the available options of development strategy are also very limited. Two priorities are self-evident, however. First, given the overwhelmingly agrarian structure, the only way economic progress for most of the population can be achieved is through a significant increase in agricultural productivity. The industrial sector, which represents one-fifth of GDP, has little potential to become a powerful engine of growth in the near or medium term in view of the low domestic demand, untrained labor force, and remoteness from world markets. Second, in order to break the constraint on domestic resources in the longer term, Upper Volta must develop its human potential, calling for a concerted effort especially in education.

8. On the first point, a development program to expand the productive potential of the agricultural sector must include increased efforts of agricultural research, to adapt and apply the findings of pure crop research to local conditions. Promoting wider use of the technical packages that are available is also necessary, although at present such new technologies can be applied economically only on a few crops in the more favored ecological areas. The development of improved cultivation practices should be directed to increasing the economic efficiency of food production and conserving the scarce soil and water resources, particularly on the central plateau where the population pressure is most intense.

9. Developing Upper Volta's human resources through investment in basic education and primary health care could have widespread economic as well as social returns over the long term by improving the population's receptiveness to technological change and even by raising the benefits of migration to the migrants and their families. A significant investment program in these areas would require a major infusion of foreign financing for operating costs, however, as the government's ability to meet recurrent expenditures in these sectors is overstretched by the low level of services already provided.

Bank Strategy and Operations

10. Bank Group lending in Upper Volta has focused heavily on rural development through projects to promote production of cotton and cereals in the southwest and small-scale investments on the central plateau. The lending operations have followed a pattern of repeater projects to build on successful first credits where it is clear that extended external financing is needed to permit the project area to achieve sustained growth. The more recent Bank credits in the sector include components to monitor and evaluate the impact of agricultural extension and of research trials, and increased emphasis on more efficient food production.

11. The Bank's two education projects have been instrumental in establishing a young farmer training program to provide an agriculturally-oriented basic education to youths who do not gain access to formal schooling. The program appears to have achieved some promising results, although it is still too early for a definitive assessment. The replicability of this program as a solution to basic education for the country remains an unresolved issue,

however, since the unit costs of the young farmer training are still high relative to the country's recurrent financing capability and the growing demand for schooling. The financing of operation and maintenance costs is also a pressing issue in the highways sector, where the Bank is presently preparing a fourth project.

12. By almost any set of growth assumptions, Upper Volta will continue to face abject poverty for many decades to come - the most optimistic projections place the expected increase in real GDP per capita no higher than 2 percent per annum over the next 10-20 years. Although Bank projects have generally been successful in meeting specific, limited objectives, our operations at this juncture must confront three strategic issues: (a) whether there is any way to speed up income growth, either by financing more and larger projects of the present type or through an alternative set of interventions; (b) related to (a) whether a major program to develop the country's human resources would be a surer path to both faster economic development and improved social welfare over the long term; and (c) if we accept to significantly change our lending strategy in either case, it will be necessary to undertake major adjustments to our pattern of financing in Upper Volta, to cover a large share of recurrent costs directly on a long-term basis and take a firm lead in coordinating aid with other donors.

WA1C
March 31, 1981

COUNTRY PROFILE: IVORY COAST

Population: 7.8 million
GNP per capita (1979): $1,060
External debt: $4.6 billion
Debt Service Ratio: 29%
of which Bank Group: 1.2%

	Lending (in $ millions)			
	FY76-80	FY80	FY82	FY81-85
Bank	366.4	33.2	128.5	700.0
IDA	-	-	-	-
	Number of Operations			
Bank	17	2	3	19
IDA	-	-	-	-

1. The Ivory Coast became independent from France in 1960. The first President, who has just been re-elected for a further five-year term, provided the country with political stability in a one-party political system within which a variety of tribal and regional interests exist and are reconciled.

Past Performance

2. The Ivorian model of development was based on liberal and pragmatic policies to exploit the country's potential in export agriculture (coffee, cocoa, timber) supported by public investment in infrastructure, and an open door to migrants from neighboring countries provided a plentiful supply of labor for forest zone agriculture expansion. The smallholders who are the principal producers of coffee and cocoa earn the highest prices in West Africa under an efficient export processing and marketing system. Recognizing the economic vulnerability of too much dependence on the three export commodities, diversification took place on both plantations and on smallholder production of oil palm, rubber, pineapple, rice and cotton. In short, by a judicious use of both local and foreign factors of production and favorable markets, the Ivory Coast achieved the highest GDP growth rate (7 1/2 percent annually) of all African countries with the exception of a few oil exporters. GDP per capita rose to $1,175 in 1979 current prices.

3. As the earlier concentration on developing the resource-rich South had created disequilibrium vis-à-vis the North, and as there is a great dependence on expatriates in higher-level jobs, diversification also had as an objective the improvement of income distribution. In the long run, Ivorianization would be promoted by education. The response to these differences in income and opportunities was a shift in population to the more richly endowed South from the North and from neighboring countries; many of these people did not stay in agriculture but moved to Abidjan which is experiencing the classic problems of overurbanization.

4. The tripling of crude oil import prices between 1973 and 1975 had little impact as oil represented a small part of imports and the value of both coffee and cocoa exports rose by even more in the period. Beginning in 1976, world coffee prices began to soar as the number one exporter, Brazil, was struck by devastating frosts in July of that year. Cocoa prices also began their rise some months later also as a result of supply shortages in world markets. As a consequence, the Ivory Coast's export earnings for coffee and cocoa together were to average $1,2 billion (CFAF 278 billion) annually over the four-year period beginning in 1976--three times the earnings realized on average during the preceding four years. Half the country's coffee/cocoa earnings in this period were captured by the Government through its Agricultural Stabilization Fund (CSSPPA) which earns the difference between the sales price and costs, including payments to producers.

5. On the basis of these exceptional surpluses, public external borrowing also increased as a response to perceived increases in debt service capacity. Thus, external borrowing increased from $450 million in 1975 to $1.8 billion in 1977. The Ivory Coast's public investment program for 1976-80 was doubled in real terms over that realized in the first half of the seventies, with the objectives of maintaining an annual growth rate of 8 percent while at the same time reducing regional income disparities and augmenting social welfare services throughout the country. The general pressure of accelerated activity was accentuated by the inflationary domestic impact of the high cocoa-coffee earnings and rising prices of oil and other imports.

6. During 1977, the burden of uneconomic projects in the Public Investment Program, overdependence on external borrowing, and these domestic problems began to become apparent. In line with recommendations by World Bank staff in 1978, the Ivorian Government took steps to contain the growth of the program and centralize control of investment decisions, including the investment and borrowing of the public enterprises which had accounted for a good share of the expansion.

Current Problems

7. The consequences of past borrowing still weigh heavily on the budget and balance of payments even though new commitments were curtailed in 1978, 1979 and 1980 following periodic reviews by the Bank of their investment program, as requested by Government. Although the country has been responsive to the policy dialogue with the Bank, it was ill-prepared for the 30 percent decline in the terms of trade between 1977 and 1980. Export receipts in 1981 are expected to be $1.7 billion lower than they would have been at 1977 coffee and cocoa prices in real terms. Further, the debt burden will approach 29 percent of the export of goods and services in 1981.

8. The IMF in the recently agreed Extended Fund Facility, prepared with our help, will cover the immediate need for financial resource transfers. The Financial Recovery Program agreed to by the Government contains a series of measures. On the revenue side, it raised gasoline taxes, the retail price of rice, prices of electricity, water, bus, air and rail transport. On the expenditures side, it imposed constraints on the current budget; reduced

salaries in public enterprises and the producer price for rice; and cancelled public investment projects to keep expenditures at the 1980 level of CFAF 399 billion ($1.9 billion)--a decline of about 10 percent in real terms. The Government will also limit external borrowing of less than 12 years' maturity to CFAF 160 billion ($700 million) in 1981. The EFF would give the Ivory Coast a total of SDRs 484 million, of which about SDRs 200 million would be made available during 1981.

Prospects

9. The medium-term prospects for the country are good. The foresighted Ivorian energy policy based on constructing hydroelectric facilities to replace fossil fuels and a program of oil exploration has begun to pay off. Oil output is expected to cover domestic requirements of 2 million tons by 1983. By 1985, a new field--the full extent of which is still unknown--is expected to yield a further 3 million tons. The most optimistic estimate places total output at up to 20 million tons by the end of the decade. The Government is aware that it has a limited period in which to establish an effective financial control mechanism and to build the absorptive capacity for productive investments which would allow the country to avoid the adverse effects of large oil surpluses experienced by others. In this respect, raising agricultural output and productivity in the Center and North as well as promoting efficient industrialization will be important aspects of a development strategy to provide self-sustaining employment and improved income distribution for the bulk of the people. If the expected oil revenues do not materialize, adjustments in the economy, particularly in agriculture, will be even more necessary if more modest growth, equity and employment objectives are to be attained.

Bank Strategy and Operations

10. Like many other French-speaking countries in Africa, the Ivory Coast relied very heavily on French and occasionally other bilateral financial assistance during the years following independence. Since 1968, when the Bank made its first loan (only one IDA credit was made in 1973) to the Ivory Coast, our basic strategy was to establish our credibility by doing carefully designed projects containing substantial institution and manpower training components to which we were able to progressively attach reforms in sectoral economic policies. We thus supported government policies of diversifying and expanding forest zone agricultural production where the country had the greatest comparative advantage, creating a suitable complementary infrastructure and developing the country's human resources. Until 1978, the Bank made 11 loans to the country in support of cocoa, rubber, oil palm, coconut and cotton development; financed six highway and one telecommunications projects and two education projects; later in response to rapid urbanization, the Bank was also active in financing urban infrastructure in Abidjan through four projects in the fields of water supply, sewerage and urban transport and development. Our activity in the industrial sector was channeled through intermediary institutions, i.e. local development banks, to finance industrial projects, small and medium enterprises and tourism. As our institution building succeeded, we were able to make our first sector loan in road transport this year to finance a major part of the Government's highway investment program.

11. As Government shifted development emphasis to redressing regional and income distribution imbalances, we launched integrated development projects in the different regions and moved from development of estates to smallholder production projects. Lending for water and power distribution to secondary cities is being pursued.

12. Since our basic report in 1977 analyzed the problems of diminishing returns for the next phase of Ivorian development after a period of highly successful growth, the country has, as noted earlier, gone through a series of shocks relating to dramatic terms of trade changes. Our policy influence became increasingly important in this period as we were called upon by the highest authorities on a number of occasions to assist in crisis management.

13. Our August 1980 CPP concluded that while our economic dialogue had been effective in averting financial crisis, a more fundamental approach in the form of a structural adjustment program, based on reforms in macroeconomic management, agriculture, public enterprises, industrial incentives and the education system, was warranted in order to reduce the resource gap to manageable proportions while adjusting the economy to the realities in the eighties.

14. We are currently preparing a program of structural adjustment loans, the first in FY82, as the necessary supply-side complement to the Fund's financial recovery program. Our program will assist the Government in carrying out a series of specific reforms in these fields starting with the critical agricultural sector.

West Africa Region
March 25, 1981

LAC

Country Statements

ARGENTINA

A. Political Overview

1. Background. By 1973, when Peron returned from exile, the country's social fabric had seriously disintegrated. Peron proved unable to weld together the disparate factions and reconcile competing claims; his death and the succession of his inept wife to the Presidency plunged Argentina into its deepest political crisis. The military takeover in March 1976, marked the dawn of a new political era. During General Videla's term as President, which will end March 29, 1981, public political activity was virtually suspended. Efforts were placed on establishing civic order, stabilizing the economy, and calming down political rhetoric. President-elect General Viola, is expected to open a dialogue with the traditional political parties. Unlike his practical, apolitical predecessor, General Viola is said to be a shrewd politician with liberal tendencies, not fully shared by a number of ranking fellow officers. It is said that General Viola wants to initiate a transition to a stable civilian government and to get the army to return to the barracks for good.

2. Issues. The change in governments raises several issues: (a) "political opening" - economic decision making is likely to become more politicized, subject to increasing influence of interest groups. Unpopular policies aimed at increasing efficiency may be watered down. Possibilities of conflict between military and civilian groups may well increase; (b) conflict with Chile - the sharpening conflict over the Beagle islands will strengthen the hand of the military; it could become a nationalistic ploy to rally the populace if the economy deteriorates; it could also provide an excuse for the military to keep a grip on key industries and reverse the existing trend of privatization of the economy; (c) decentralization of economic team - Martinez de Hoz's ministry has been split into five. Whereas Martinez de Hoz always had the upperhand to convince military leaders to accept his decisions, there is now a power dispersion with a number of players, making it more difficult to pursue homogenous policies.

B. Economic Overview

3. Background. Frequent and drastic reversals in economic policies, sharp conflicts among interest groups, inefficiency in the public sector and excessive protection of industry are among the factors responsible for Argentina's unsatisfactory slow rates of growth since World War II. The economy reached bottom in early 1976; the inflation rate approached 800 percent, foreign exchange reserves were exhausted. President Videla's economic team was able to improve the balance of payments within a short period, restructure the external debt and reduce hyperinflation. After the initial stabilization success, a new program was introduced in late 1978 which gave priority to lowering inflation further while modernizing the economy. It differed from previous ones by relying heavily on foreign trade policy as a deflationary tool: the exchange rate was devalued according to a predetermined schedule, leading to a revaluation in real terms, and protective tariffs were reduced gradually. Thus external competition was used to make industry more efficient and constrain its ability to raise prices. The program's initial results were impressive. Inflation slowed down markedly (wholesale price increased by only 60

percent in 1980) real fixed investment increased, GDP expanded and the public sector deficit decreased. These gains, however, were not without costs: the industrial sector has experienced record bankruptcies; excessive debt financing, combined with high interest rates, has led to mounting liquidity problems for both public and private enterprises; the banking system may be on the verge of a severe crisis as a result of bad loans and business failures. During 1978 and 1979, surpluses on both trade and capital accounts produced large increases in reserves. By 1980, however, the peso was becoming increasingly overvalued as inflationary movements exceeded the pegged devaluations by a substantial margin, and the trade balance turned negative. High domestic interest rates and the country's large reserve cushion continued attractive to foreign lenders, but nervousness about the stability of the peso grew perceptibly during the second half of the year. Instead of relieving this pressure, the 10 percent devaluation of the peso in February 1981 exacerbated speculative fears of a further large exchange rate adjustment. The flight into dollars caused a massive drain on the Central Bank's reserves which halted only after interest rates rose to levels approaching 60 percent in real terms. While effective in the short term, this policy cannot be pursued over a longer period without risking depression.

4. Issues. The new cabinet includes representatives of major interest groups who have been critical of Martinez de Hoz; as a consequence, the transition may not be as smooth as expected, and policies could be relaxed or reversed. The new economic team faces major issues in three key areas: (a) tariff policies - interest groups are exerting pressure to reverse the present policy of reducing import tariffs; drastic changes would jeopardize progress made in restructuring the industrial sector and hamper anti-inflationary efforts; (b) exchange rate policy - a large devaluation would help exporters but seriously hurt enterprises holding foreign currency liabilities, and, unless accompanied by firmer aggregate demand management and further trade liberalization measures, the consequence would be renewed inflationary pressures and a restoration of former levels of import protection; (c) monetary and fiscal policies - the fiscal deficit will have to be reduced as part of a credible anti-inflation program, permitting interest rates to fall and avoiding a serious private sector liquidity crisis.

C. Role of the World Bank

5. Volume and Strategy. Past Bank lending to Argentina has been sporadic because of periodic macroeconomic difficulties and unsatisfactory sector policies. After a hiatus of five years, lending resumed in September 1976 Since then, the Bank has approved 10 loans amounting to US$886 million with two loans totaling $250 million ready for negotiations. The Bank's lending strategy, in support of Argentina's stabilization efforts, has had three objectives: (i) to rationalize public sector policies; (ii) to promote public sector decentralization and transfers to the private sector; and (iii) to restructure the industrial sector.

6. Past Performance. The overall performance of Bank financed projects has not been satisfactory: (a) a $60 million loan for Agricultural Credit was cancelled and the Grain Storage Loan is being restructured; (b) on average, project execution has been delayed by about 26 months compared to appraisal estimates; and (c) only 20 percent of the Bank loans commited since 1976 have been disbursed. The problems can be traced to a combination of: (a) institutional weaknesses and cumbersome administrative procedures; (b) limitations on Government contributions in order to contain fiscal deficits; (c) ceilings on public sector tariff increases in order to control inflation; (d) acceleration of Government policies to increase

private sector participation; (e) revaluation of the exchange rate as major instrument of stabilization policies. While Bank lending has constituted only a small part of Argentina's financial flows, the Bank's presence has contributed significantly in several areas: (a) institution building - the National Development Bank has streamlined operating procedures; responsibilities in the power sector have been redefined; management procedures and organization in the railways, highways and power entities have been changed and strengthened; a comprehensive hydrocarbon pricing policy has been prepared and the state oil company will be significantly strengthened; (b) investment planning - a long term power investment plan has been completed which rationalizes development of hydro, thermal and nuclear development; the National Transport Plan is beginning to have an impact on sector organization and investment allocation for individual modes; and (c) operating efficiency - most impressive are the achievements in the railways. Closure of uneconomic lines and staff reductions are ahead of schedule, operating targets except for financial parameters are being exceeded. The highway agency has been able to lower significantly unit construction and maintenance costs, and the power company shows improved efficiency parameters.

7. Outlook. The scope of the Bank's future role depends on several factors: (a) improved implementation - recent developments are positive; the disbursement rate is picking up, agreed execution schedules are generally adhered to, and major issues relating to the large Yacyreta hydroelectric project are being resolved, although some others, related to procurement, are expected to emerge; (b) per capita income - at $2300 per capita GNP (1980), Argentina is one of the Bank's more developed borrowers; however this figure masks chronic institutional weaknesses that are among the main factors constraining growth, justifying continued Bank assistance; (c) future economic policies - the biggest unknown concerns future economic policies, particularly those relating to public sector tariffs, petroleum pricing, and monetary exchange rate and trade policies. If no major issues surface, proposed Bank assistance would be on the order of 2-3 projects and $200-300 million per annum. Major areas of assistance include hydrocarbon and energy development (52%), infrastructure lending (22%), industrial credit assistance (15%), and assistance for education and agriculture (11%).

8. In conclusion, the new Government faces a rough road ahead. In response to public pressure, it will probably modify some of the previous policies; the degree of relaxation and the accompanying monetary and fiscal policies will determine the inflationary impact and the degree, if any, to which long-term structural reform objectives are sacrificed. It will be important that the new administration establish a degree of confidence early on; the decentralization of the economic ministry could complicate this task. The country's foreign exchange position at present is still strong and export prospects for the coming year are good; the Government will have some breathing space. There is a risk that Argentina will once again abort stabilization policies prematurely and revert to expansionary and protectionist measures.

BRAZIL

Political Situation and Trends

1. During the 1950s and early 1960s Brazil was governed by a series of elected regimes with a populist orientation. In 1964, after several years of increasing inflation and political confusion, the armed forces, with tacit popular support, took control of the Government. The early years of military rule were marked on the economic side by strong anti-inflationary measures, including severe wage restraints, and on the political side by severe repression. After 1967 economic policy became more expansionist, but tight political control was enforced by the military until the mid-1970s. The Geisel administration (1974-79) began a process of political "opening", which has accelerated under the present Figueiredo administration. Press censorship has been removed and amnesty for most political prisoners declared. Popular election of the federal president is scheduled for 1985, and expectations are that he will be a civilian.

Economic Situation and Trends

2. With a rich human and natural resource base, Brazil's long-term economic outlook is excellent. The "miracle years" 1968-73 demonstrated Brazil's potential for growth when conditions are favorable. Growth of some 11% per annum in those years was partly made possible by previously idle capacity, but it at the same time reflected the manifold natural advantages with which the country is endowed and its ability to modernize its institutions and mobilize resources for development. Important policies adopted during this time that have been continued to the present include a strong emphasis on agricultural development, the stimulation of manufactured exports, and the "crawling peg" exchange rate system, under which the cruzeiro is devalued frequently in accordance with the difference between domestic and foreign inflation. The Government has now launched some important programs to combat poverty.

3. The rate of growth has slowed to 7% per year since 1974, reflecting the balance-of-payments constraint introduced by high petroleum prices and, more recently, the high cost of servicing the rapidly accumulating foreign debt. The major required adjustments now are to increase the domestic savings rate, to develop alternative energy sources, and to expand exports. Both the energy substitution effort and the export drive have been successful up to now. However, under the most reasonable assumptions regarding the future course of petroleum prices, reduced oil import requirements, external borrowing costs and export growth, Brazil will need very large amounts of new external, private, financial credits at least through 1982 to sustain the projected GDP growth rate of 5-6%. Once this "hump" is

passed, however, barring unexpectedly unfavorable developments in the above variables, and assuming appropriate demand management and exchange rate policies and continued progress in oil conservation and substitution, the rate of net borrowing and the debt service burden can be expected to decline sharply. In other words, although private bank exposures in Brazil would have to grow substantially in 1981 and 1982, its relative share by 1985 would have fallen back to present levels. This scenario can only be realized, of course, if Brazil is able to retain the confidence of the international banking community. Although for domestic political reasons Brazil would prefer to avoid recourse to the IMF, it may in the end have to go to the Fund in order to assure the flow of private financing which it requires.

4. Over the past five years Brazilian governments have followed somewhat erratic monetary and fiscal policies, with periods of monetary and fiscal restraint being followed by relaxation. Since 1973, the rate of inflation has been increasing, and reached over 100% in 1980. Among the factors contributing to this pattern have been reluctance to allow growth to slow to a point where the 1-1/2 million annual new entrants to the labor force could not be employed, and institutional weaknesses affecting the economic authorities' ability to control the activities of Brazil's vast public sector. Over the past year, the Planning Ministry has greatly increased its authority over public sector expenditures and has used this power to exercise increasingly rigorous monetary and fiscal restraints. Nevertheless, agricultural subsidies are still very high (especially credit subsidies extended through interest rates that are highly negative in real terms). Partly in response to the balance-of-payments stringency, protection of domestic industry has increased. Wage policy is expansionary, and public sector prices have not been allowed to follow inflation. Finally, budgetary decisions, including those involving important long-term investments, are being taken with a short-run point of view without adequate consideration of their longer term economic and financial implications. All of these issues need to be addressed as a part of any program to adjust Brazil's economic structure to its new international situation.

World Bank Relations

5. Although Brazil was one of the earliest borrowers from the Bank, we made no loans from the late 1950s until after the 1964 revolution because Brazil was deemed to lack creditworthiness as a result of the economic policies being followed. Borrowing was resumed in 1965 and has gradually increased so that Brazil is now the Bank's largest borrower with gross commitments amounting to \$5.4 billion. Loans at present disbursed and outstanding amount to \$2.0 billion, and there are \$2.6 billion of undisbursed commitments. In each of the past three fiscal years new loans have reached about \$700 million. We expect them to exceed \$800 million in the current year. The growth in our lending has been based on confidence in the country's long-term prospects together with generally high respect -- in spite of some reservation -- for the country's economic management.

6. The Brazilians have always shown themselves ready to discuss their economic problems and policies freely with the Bank. In some respects they have been influenced by the Bank's advice, and in all cases it has been possible to achieve a good degree of mutual understanding and respect, even though the Bank's economic views were not always shared.

7. The Bank has been pursuing several major objectives in its lending program. We have worked closely with the Brazilians to prepare a pipeline of projects addressing problems of poverty: rural development, urban development including water supply and sewerage, transport and sites and services, and basic education. At present over 50% of our lending program consists of projects whose main objective is to increase the incomes and well-being of low-income groups. We have also had a large number of projects designed to induce institutional and policy reform. Our lending in the electric power and transport sectors reflects this objective. Finally, we have financed a group of projects whose main purpose is to ease the balance-of-payments constraint by increasing exports or, when economically justified, creating substitutes for imports. In this category we have financed steel, fertilizers, petrochemicals, aluminum and iron ore mining projects. Over the next year or two we would like to increase the share of our lending devoted to helping Brazil resolve the energy problem and expect to make loans for fuel alcohol development, a gas pipeline, shale oil, and energy savings projects in steel and other industry.

8. There have been two chronic problems encountered in our lending, especially in the past two or three years. One of them is the Government's failure to permit adequate increases in public utility tariffs. Performance has recently improved in both the electricity and water supply and sewerage sectors but we hope to persuade the Brazilians to make further increases in electricity rates before our next loan for that sector. The other problem has been Brazil's practice of granting heavy interest rate subsidies to favored sectors of the economy, especially agriculture. Industrial interest rates have recently been reformed and in most cases are now positive in real terms, but agricultural rates remain highly negative. The prospects for new lending for agricultural credit programs are therefore not bright.

9. Now that the Government has taken some energetic measures to control public expenditures, some of the projects that we have financed in the past few years that are now in execution are encountering counterpart funding problems. We are addressing these cases one by one and are prepared to agree to a stretching out of project execution in many instances in order to cooperate with the Government's anti-inflationary program. A structural adjustment loan is not presently being considered. However, the Brazilians have expressed interest in one or a series of large, quick-disbursing sector loans.

THE CARIBBEAN REGION

1. The Caribbean Region includes all the countries which participate as actual or potential beneficiaries in the multinational consultative group formed and chaired by the Bank for this area (see para.15 below). They include the 17 English-speaking countries and territories known as the Commonwealth Caribbean (CC); the Dutch-speaking Netherland Antilles and Suriname; the Spanish-speaking Dominican Republic; and the French-speaking Haiti. Owing to its geographic and political fragmentation, small size, limited natural resources, and the seriousness of its current economic problems--emerging partly from the impact of oil price increases and, in most countries, also from past domestic mismanagement--this area poses a uniquely difficult challenge to the donor community as a whole, and, in particular, to the World Bank. This paper concentrates on issues related to the CC.

A. The Commonwealth Caribbean

2. The CC embraces a total population of about 5.3 million in 1979 with a combined GNP of about US$9.0 billion. It includes the independent countries of Bahamas, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago; the United Kingdom (UK) Associated States of Antigua and St. Kitts-Nevis; and the UK Crown Colonies of Anguilla, Belize, British Virgin Islands, Cayman Islands, Montserrat and the Turks and Caicos Islands. All the independent countries, except for St. Vincent and the Grenadines, are Bank members. St. Vincent and the Grenadines is expected to become a Bank member later this year, and Antigua, Belize and St. Kitts-Nevis should also become independent, and members of the Bank, by late 1982. Common practice is to distinguish between the relatively more developed and larger countries (MDCs) of Bahamas, Barbados, Guyana, Jamaica and Trinidad and Tobago, and the remaining less developed and smaller ones (LDCs).

Background and Main Characteristics

3. The CC countries have in common many characteristics. Politically, all of them used to be UK colonies. The 1960s witnessed independence for some of them, and by 1980 most of them had become independent nations. As a result of their British heritage, all of them have parliamentary traditions. Their political institutions, however, particularly in the LDCs, are still fragile as the 1979 Grenada coup illustrates. Trade unions have, in most of them, a long and strong tradition, and many of the political leaders of today have their roots in the trade union movement.

4. Economically, most of these countries are characterized by their smallness and by their heavy dependence on external trade, investment and financial assistance. Most of them depend on a few primary products--sugar, banana, bauxite--and/or on tourism. Only Trinidad and Tobago has a significant amount of hydrocarbons. Almost all, particularly the LDCs, provide an extremely difficult and challenging development problem. Their colonial heritage has left them with high levels of education, but paradoxically, relatively low levels of marketable skills in the labor force. In spite of

their sophisticated political development, many of them lack effective developmental institutions. The LDCs, when they were colonies, relied on budgetary support from the UK. Foreign assistance, properly focussed, will be needed on a continuous basis and could, over the long run, reduce the unstable conditions confronting these economies.

5. Economic development has led, in most of these countries, to improved social conditions, but has not significantly reduced the very high unemployment rates. High unemployment has contributed to different degrees of social tension and unrest but, overall, the social situation has been relatively stable. The high literacy, the democratic process, the absence on the whole of wide income disparities, the existence of a limited welfare state and the extended family system have all contributed to the relative social stability of the region. Nevertheless, social stability, as well as political democracy, cannot be taken for granted. During the second half of the 1970s, they were seriously tested in some countries. In the 1980s, effective approaches for employment generation and further improve- ments in income distribution may be needed to preserve them.

6. Building on somewhat fragile foundations and common interests, the CC countries have tried repeatedly to construct a framework of regional cooperation. An early attempt was made at integration--political and economic--with the establishment of the West Indies Federation in 1958. This experiment, however, did not survive the nationalist sentiments which dominated the Caribbean. The idea of regional economic association was revived in the mid-1960s and culminated in 1968, in the formation of the Caribbean Free Trade Association (CARIFTA). Within this free trade area, seven LDCs of the Eastern Caribbean formed the East Caribbean Common Market (ECCM). In 1970, the Caribbean Development Bank (CDB) was established, and in October 1972, CARIFTA member countries decided to strengthen the integration movement still further by forming a Caribbean Community and Common Market (CARICOM). Progress towards achieving the goals of regional economic integration has been limited, partly owing to political differences. Most of such limited progress has been made in the field of regional trade and monetary arrangements, including substantial financial assistance from oil-rich Trinidad and Tobago.

Developments during the 1970s

7. During the 1960s and up to 1973, these countries enjoyed high economic growth rates,a healthy demand for their products, relatively stable prices for their large range of consumer and capital goods imports, a growing inflow of tourist earnings, substantial inflows of foreign investment in mining, manufacturing and tourism (in the MDCs) and relatively substantial amounts of UK budgetary support (in the LDCs). The external economic environment changed drastically during the 1970s, and, with the exception of Trinidad and Tobago, economic performance deteriorated throughout the CC.

8. Among the MDCs, Bahamas and Barbados experienced low economic growth and/or stagnation through 1975/76, but performed well in subsequent years. Their relatively good performance has been assisted by political stability, an active private sector and good economic management. Jamaica and

Guyana, on the other hand, faced during the 1970s a substantial deterioration in their living standards. In these countries, internal policies compounded the effect of adverse external developments. Both engaged in ambitious and poorly managed programs to redistribute income and wealth. Unnecessary political rhetoric and varying degrees of intended--and sometimes unintended--hostility towards the private sector led to a decline of private investment, capital outflows, emigration of badly needed managerial, professional, and skilled labor, and to a substantial deterioration in labor relations. Both countries also faced increased fiscal and balance-of-payment current account deficits that led to harsh adjustment measures. By 1980, the prospects for investment, growth and balance of payments stability werediscouraging, but, in recent months, the outlook has improved with the change of leadership in Jamaica and a more positive attitude towards the private sector in Guyana.

9. Economic performance of the LDCs during the 1970s was uneven. Most of these countries had to adapt not only to a drastically changed external economic environment but also to their newly acquired independence, and to reduced levels of UK budgetary assistance. Living standards in some of them decreased in the early and mid-1970s, but have recovered since. Most of them, however, face serious problems of economic viability.

Prospects for the 1980s

10. During the 1980s, all the CC countries, must, to a greater or lesser degree, carry out a process of structural adjustment. This will be difficult and will require courage. Nevertheless, there is reason for some degree of optimism. With respect to the MDCs, Barbados and the Bahamas should be able to continue their relatively better performance. In Jamaica--and to a degree, Guyana--there is an incipient but clear trend towards more realistic and responsible economic management. In some LDCs, however, the roots of the economic problems go deeper, and their economic viability is still in question. For these LDCs, greater regional integration must be an integral part of their programs of structural adjustment.

Bank Group Lending

11. The Bank direct lending program for the MDCs totals US$311 million for FY81-85, including US$21.0 million for Bahamas, US$31.0 million for Barbados, US$85.0 million for Guyana, and US$174.0 million for Jamaica. Of these countries, only Bahamas and Barbados are clearly creditworthy. This program might be increased in the near future if the creditworthiness situation of Jamaica and Guyana continues improving. In Bahamas, the program covers urban development, education and agriculture. In Barbados, power, agriculture, and energy projects are under consideration. In Guyana and Jamaica, the recent trend towards more responsible and effective economic management has enabled the Bank to consider structural adjustment lending. An SAL was recently approved for Guyana, and one is being considered for Jamaica. A key element in Guyana's economic strategy is the development of a hydropower and related aluminum processing project, which, if feasible, might be supported by the Bank. The Bank does not have presently an active lending program in Trinidad and Tobago.

12. The current Bank lending strategy for the Commonwealth Caribbean emphasizes the role of its indirect lending through the CDB, which includes financing small projects in the MDCs and all the planned Bank Group financial assistance for the LDCs. Since its establishment in 1972, the CDB was considered a channel which should enable the Bank to assist the small Caribbean countries at a relatively low administrative cost. Up to now, the Bank Group has provided US$51 million to CDB (including US$7 million in IDA credit) and the FY81-85 program envisages assistance for US$77 million (including US$22 million from IDA). The CDB performance, however, is now below original expectations. Its technical staff is still very small, and its management is too weak to resist political pressures from the recipient countries. The recipients consider CDB too slow in processing loans--a complaint at least partly justified--and its main donor members--UK and Canada--as well as the US, believe that CDB expansion should proceed slower than previously expected. As a result, the LDCs which are becoming World Bank members, supported by Canada, UK and US, are increasingly pressing us for direct financial assistance. Since the availability of IDA resources is not likely to allow simultaneous direct and indirect lending in meaningful amounts to the LDCs of the Eastern Caribbean, and since these countries are not creditworthy for Bank lending, a decision will have to be made later this year on which of the two courses of action should be followed. Both alternatives are relatively costly for the Bank Group. Under the first one, we have been reimbursing CDB for the cost of "retailing" our IDA credits to the LDCs of the Eastern Caribbean. Under the second, such reimbursement would no longer be necessary, but substantial additional staff time would be required to handle direct lending.

B. The Caribbean Group

13. At the request of the US and Venezuela, and, subsequently, of some Caribbean countries, the Bank established in December 1977 the Caribbean Group for Cooperation in Economic Development--a multinational consultative group which by now includes as members 21 Caribbean countries, 15 donor countries (including the US, Canada, Japan, most of Western Europe and several Latin American countries), and the IMF, IDB, CDB, UNDP, the European Economic Community and about 10 other international institutions. The Group has met three times (in June of 1978, 1979 and 1980), and a fourth meeting is scheduled for June 1981. Until June 1980, it helped mobilize about US$530 million in program-type balance of payments support, as well as substantial amounts of project financing and technical assistance. The Group has also been successful in promoting some regional programs, particularly those related to private sector development, export promotion, tourism and energy. Given its success, the Group operations are now strongly supported by most donors and recipients. The Group is quite costly in terms of staff time, and demands from donors and recipients for additional technical work for the Group are increasing. Up to now, however, we have been able to limit somewhat the impact of the Group operations on our administrative budget by obtaining the technical and/or financial support of other institutions (particularly UNDP, IMF, CDB and EEC) and bilateral donors (US, UK and Canada).

COLOMBIA

I. Political Situation and Trends

1. Colombia has a long tradition of democracy, with more than 20 years of governments elected by the people. The Turbay Administration obtained a large majority in the past election. President Turbay, a consummate politician, has been able through negotiation and compromise to maintain party loyalty and cohesion, and by judicious appointments of opposition party members to cabinet posts has minimized inter-party conflict. Although successful in the political front, the President has been criticized for not providing enough leadership on economic matters. A recent cabinet reshuffle and a renewed public commitment to social and economic progress has apparently reduced discontent, for a time, at least. There is in the private sector, however, concern that the Government's decision-making process has become too politicized, and with the next Presidential election scheduled for March 1982, some of the problems confronting the economy--inflation, slowdown in real growth, growing unemployment and increasing dependence on imported energy--will remain for the next Government, which will take office after August 1982. Guerrilla activity, which was a problem in the past, has subsided considerably and illegal drug traffic has weakened, because of the Government crackdown of these activities and partly because of increased international competition. The campaign for the forthcoming election is taking shape gradually. The Liberal Party appears to continue having a considerable margin (if elected this would be its third consecutive term in office). The former Ambassador to the U.S. and for many years a Bank Executive Director, Virgilio Barco Vargas is gaining support within this party.

II. Economic Situation and Trends

2. The Colombian economy has made considerable progress over the past quarter century. It evolved to a more integrated urban-industrial and services orientation (over 68% of the population is now urban, compared with 50% in 1960), from a largely rural and agricultural base. Its productive structure was broadened appreciably as output became more diversified. Greater reliance on foreign trade allowed the external sector to grow, with non-coffee exports, particularly manufactured goods, expanding rapidly. Public sector investment and output came to play a greater role. The domestic financial market evolved pari-passu with the growing needs of the economy and Colombia has become an active participant in international capital markets. The foreign exchange shortages which the economy suffered from for many years because of sharp coffee price fluctuations have moderated, and the country has become more resilient to external shocks. This has been the result of the deliberate efforts of several administrations to establish an outward-looking development strategy (export promotion policies, including periodic exchange rate devaluations and export tax rebates, together with the lowering of tariffs and the freeing of products and capital markets from controls). In addition to relieving the foreign exchange constraint, this strategy stimulated economic growth. In future, more will have to be done to open the economy to imports by rationalizing and liberalizing the licensing system.

3. Between 1976 and 1979 the economy experienced both high rates of economic growth and strong inflationary pressures resulting mainly from excessive aggregate demand. Exports expanded, unemployment declined and real wages rose significantly in the rural areas, and were maintained in the urban sector. The Colombian authorities decided on economic stabilization and adopted a wide range of restrictive monetary and trade policies, including reduced public investment. This effort proved futile as unanticipated events--two coffee frosts in Brazil,

increased foreign exchange receipts from illegal (drug) exports, rising domestic gold production and large capital inflows induced by high interest rates--caused a rapid expansion of foreign exchange (at the end of 1980, net foreign exchange reserves were equal to one year's imports), thus exerting additional pressure on domestic prices. The stabilization program appears to be taking hold. Real economic growth in 1980 is estimated to have been no greater than 3-4% (down from an average growth of 6% per year during 1976-79). A recession in the construction industry caused by saturation of the high income market, a drought which affected agricultural production, and slower export growth have also contributed to deflate the economy for the whole of 1980. Inflation was reduced to 26% from 29% in 1979. The authorities, therefore, began to stimulate the economy and there are already some positive signs of recuperation.

4. Although broad improvements in economic and social welfare have occurred, poverty remains a major problem in Colombia. While all income groups have gained in absolute terms from the increases in real per capital income, in relative terms, the lower and higher income groups appear to have benefitted the most. The lower income group in particular were helped by the heavy Government outlays to provide basic needs.

5. The base of the economy is strong and its medium- and long-term growth prospects are favorable. The country has an abundance of resources, including ample arable land, minerals and primary energy resources, and its debt and debt-service burdens are low. It has a history of good economic management and exceptional entrepreneurial ability. Still, there are obstacles to growth that require prompt attention. Colombia became a net oil importer in 1976 and by 1986 petroleum imports are projected to absorb over 30% of total merchandise exports. In the absence of rapid energy development, energy shortages could become a major constraint on growth. Resolution of the energy problem depends upon the country's success in developing its abundant domestic energy resources--hydro-electricity, coal and natural gas--and also upon increasing petroleum exploration and development. For this to happen, further progress needs to be made by the Government in developing policies that promote sound energy pricing in line with rationalized consumption and resource availabilities, a least-cost program of investments, sufficient domestic and external financing for these investments, strengthened sector institutions and speedy and improved programs execution capability. Although planning and policy-making have improved substantially in recent years, overall planning and coordination in the energy sector is still weak. The Government and the Bank are working closely to strengthen the sector's performance.

6. With the heavy emphasis placed by the preceding Governments on social programs, the country's transport infrastructure has been substantially neglected. Today Colombia has high transportation costs and inadequate services. This situation could slow down economic growth, particularly that resulting from the development of the country's vast coal reserves and agriculture. The State Railway is in poor condition, the road network needs maintenance and rehabilitation and the antiquated port facilities cannot cope with increased traffic. At the same time, intermodal coordination and energy conservation efforts are deficient. The Government, therefore, proposes to allocate an important share of investment resources to the transport sector; the Bank is cooperating with the Government in finding appropriate solutions to these problems.

7. The Government is firmly committed to buttressing the elements which allow sustained economic growth. It proposes to increase public investment, while at the same time continue with the stabilization program. It is aware that it needs to mobilize substantial domestic resources to finance the investment program's

rapid execution, for which it will have to take additional fiscal measures, including appropriate pricing of public services. Making the transition to higher public spending without renewing inflationary pressures will require careful economic management. Also, to strengthen the external sector it will have to improve the competitiveness of Colombian exports through increased efficiency, timely devaluations and import liberalization. Given Colombia's good economic performance, it is reasonable to expect that the authorities will be taking all the necessary actions.

III. World Bank Relationship

8. The Bank has maintained a very close relationship with Colombia for over 30 years, with active economic dialogue and intimate involvement in the development process, particularly in the power, transport and industrial sectors. The Bank has also supported pioneering activities in rural development, nutrition, water supply and education. To date the Bank has made 90 loans and one IDA credit to Colombia, totalling US$2.9 billion equivalent.

9. Colombia is creditworthy and is expected to remain so. The Bank's program is designed to give heavy emphasis to energy development, transport infrastructure and institution building. The main thrust of the Bank's lending program will be to support Colombia's efforts to prevent energy scarcities and to upgrade the country's transport infrastructure. Continuing emphasis will be given to the productive sectors, i.e., agriculture, industry and mining. Part of the program will also aim at social programs but in lesser degree than in the past, as it is felt that the Colombians themselves are already making substantial progress in this field. The objective is to supplement this effort in areas where the Bank can contribute to institution building and thus, to the sector's absorptive capacity. The Bank's efforts will be concentrated upon rural development, nutrition, water supply and, possibly, rural education, with the objective of assisting the poor.

10. Given the task ahead, Colombia will require substantial gross external capital inflows over the next five years (about US$1.8 billion per year). To reach this target, the Bank has been encouraging co-financing from commercial banks and suppliers' credit, particularly on large projects. The Consultative Group for Colombia, which is made up of representatives from the major industrial countries, has provided a forum in which the Government has enlisted financial support for its investment progrma. Although Colombia's growing economic strength has lessened the usefulness of the Group, preparations for the meeting have helped the Government to introduce discipline in the public investment exercise. Furthermore, the Consultative Group has branched out and there are now sessions with the commercial banking community following the official Meeting.

MEXICO

The Political Scene

1. Mexico will be going through a sensitive political period during the next few months. President Lopez Portillo is expected to announce, sometime after September 1981, his party's candidate for the election of July 1982. Since the Partido Revolucionario Institucional (PRI) traditionally commands an overwhelming majority of the votes, Mr. Lopez Portillo is, in fact, considering who his successor to the Presidency will be. By tradition, the candidate is chosen from among cabinet members and Messrs. de la Madrid (Programming and Budgeting) and Ibarra (Treasury), who are well known to the Bank, are rumored to be on the short list of about six Secretaries.

2. It is unlikely that there will be major shifts in Government policy during the next six-year administration though, as in the past, the new President will impose his own style and emphasis on established policies. Some political issues, however, may become critical and the most important on the domestic front could be labor relations. Union leadership has supported the PRI loyally throughout successive administrations since the 1940s. However, it is now old and the change to a younger generation could result in a splintering of the labor movement and loss of control over its more militant members. There is no reason to believe, however, that the transition would result in undue disturbance in the internal political scene.

3. Mexico has traditionally adopted an independent stance internationally. The recognition that has come with its new-found oil wealth has been readily accepted by its present leadership; numerous and distinguished heads of state have visited Mexico over the past few years. Mexico now seeks to use its influence: it has proposed a world program to conserve and rationalize the use of energy at the United Nations and has become one of the principal spokesmen for the third world in international fora. This latter role is likely to be expanded, particularly if the political situation in Central America becomes the focus of world attention.

Economic Trends

4. Following the 1976 devaluation and the 1977 stabilization program, the pace of economic growth has been resumed vigorously; annual growth rates were above 7 percent between 1977 and 1980. This expansion has been made possible by (a) a reduced foreign exchange constraint as a result of oil discoveries; this has enabled the country to expand imports at more than 30 percent annually in real terms, (b) the restored confidence of the private sector, which has been increasing its investments at above 15 percent annually in real terms, and (c) an equally fast increase in public investment. The acceleration in the level of economic activity has resulted in a strong rise in employment, which has been growing at about 4 percent per annum, i.e., faster than the rate of increase of the labor force (3.7 percent per annum).

5. The Government has not been equally successful in fighting inflation; during 1980, prices rose by almost 30 percent compared to an average of 20 percent in the previous two years. No great improvement is expected for 1981. The persistence of inflationary pressures is the result of continued overheating of the economy. Domestic demand has been fueled by excessive Government public spending and by international oil sales (more than US$10 billion in 1980), while supply has faced a number of rigidities (bottlenecks in the railway and ports systems, lack of construction materials, a shortage of skilled labor, etc.). The situation has been further aggravated by expectations of continued inflation.

6. The public sector has accounted for a significant proportion of overall demand and this has resulted in increasing financial disequilibria; the overall deficit of the public sector reached almost 8 percent of GDP in 1980. While the growth of domestic resource mobilization has been impressive (domestic savings increased from 17.5 to 22 percent of GDP between 1977 and 1980), public sector current savings were due only to PEMEX; the rest of the public sector showed negative savings in 1980. The insufficiency of public savings in relation to public investment is the result of a low level of tax revenues, of substantial and increasing subsidies to cover the current account deficit of public enterprises --most of which price their goods and services at levels which do not reflect full costs--and of agricultural support prices for producers, and low consumer prices for basic consumption commodities.

7. The continued differential between the rate of inflation in Mexico and in its major trading partners has made the need for an exchange rate adjustment an urgent one. Though a policy of modest devaluations has now been adopted (expected to result in an adjustment of about 8 percent by the end of 1981) a larger adjustment is needed. The present exchange rate is gradually eroding the competitiveness of non-oil exports and increasingly cheap imports are causing a serious displacement effect in the domestic market. The apparent reluctance of the present Administration to address itself to this problem is of concern; for the coming two years, inflation in Mexico is unlikely to decline much below 25 percent annually, i.e., more than double the expected world inflation rate.

8. While growth prospects for the Mexican economy appear good in spite of the above problems, there remains the need for vigorous action to overcome income and regional disparities and to improve the living conditions of large segments of the population, especially in the rural areas. In this respect, the current strategy of the Government, which favors increasing subsidies to lower income groups, is not the appropriate way to increase productivity and income, the only effective way of eliminating social inequalities in the long run. On the contrary, by fueling inflation, these subsidies defeat their original objectives.

Bank Operations

9. The main objectives of Bank lending to Mexico have been to help overcome the country's main development problems by supporting projects which improve the distribution of the benefits of economic growth, provide additional

employment and income to low-income groups, improve the productivity of low income farmers, reduce Mexico's regional imbalances, and, in general, make directly or indirectly a significant contribution to output and employment.

10. The Government has repeatedly expressed its desire for a continued presence of the Bank in Mexico in order that we might continue a substantive dialogue on development policy and help strengthen investment programs in priority areas. Because of its oil wealth, Mexico has a manageable balance of payments problem. Nevertheless, it is likely to continue facing complex and deep-rooted problems of income distribution, of spatial concentration of economic activity and population, of sector under-development and inadequate infrastructure and of inadequate training for a large and rapidly expanding labor force. The Bank has a useful role to play in all these fields and can make a positive contribution to Mexico's development in the context of a significant lending program.

11. Mexico is now the Bank's second largest borrower (excluding IDA). As of January 31, 1981, 69 loans for a total value of US$4,799 million had been made, of which 38 loans for a total value of US$1,870 million were fully disbursed. Some 45 percent of Bank lending had been for projects in agriculture and rural development, 16 percent for industry, 15 percent for power, and 17 percent for transport; the remaining 7 percent was for water supply, tourism and urban development projects.

12. For the future, we visualize a lending program of US$640 million for FY82 (6 projects) and US$575 million for FY83 (5 projects). Thereafter, a program of about US$600 million per year is tentatively projected.

13. Our lending is to be complemented by a broad program of cooperation with the Mexican authorities to study specific development issues. Of special importance will be a Bank review of the agriculture sector in 1981, its main problems, bottlenecks and prospects. A study of the policies for, and prospects of, manufacturing industry would also be undertaken to see how Mexico could specialize along lines in which it has a comparative advantage and attain sustained growth in manufactured exports.

14. On several occasions we have discussed the possibility of cofinancing projects with Mexican officials. In the past, these officials have not been receptive to this mechanism arguing that it would result in additional conditionality to their foreign borrowing without a measurable improvement in terms. Most recently, however, they have expressed interest in exploring cofinancing possibilities with the Bank and we plan to pursue this further in the near future. The Government has also expressed interest in actively participating with the Bank in the financing of development projects in Central America and the Caribbean.

PERU

I. Political Situation and Trends

1. Fernando Belaunde Terry of the centrist Accion Popular Party (AP) was elected President of Peru in May 1980. In a country with a complex and varied political mosaic, he won an impressive 45 percent of the votes, far outdistancing his nearest rival. The AP also gained control of the Chamber of Deputies and, in a coalition with a center-right party, has a comfortable working majority in Peru's Senate. Mr. Belaunde's inauguration in July ended a dozen years of military rule which, ironically, had begun when the armed forces ousted him from power in 1968.

2. Despite the Administration's mandate, it faces a difficult political situation. President Belaunde must deal cautiously with the military and contend (i) with the strong opposition of Peru's leftist parties, which captured 26 percent of the vote in November 1980 municipal elections, up from a 15 percent showing in the general elections; and (ii) with intense pressure from Peru's trade unions, whose members' real wages have been declining for several years. In addition, there is opposition within the populist wing of AP and amongst some industrialist to the realistic pricing and austerity measures which the Government has taken recently and to its advocacy of an open economy. Finally, a small but violent terrorist movement has emerged to add to Peru's troubles.

3. The Administration has so far been able to manage the political situation. A one-day general strike called by the unions in January to protest price increases was largely ineffectual and President Belaunde's popularity was enhanced by an outpouring of national unity during border clashes with Ecuador in February. To deal with Peru's labor unrest, the Government is trying to negotiate a voluntary social pact--with labor, business interests and Government as participants. While this idea may work, a rapid improvement in the economy--with a corresponding increase in jobs--is still the best hope for social and political tranquility in Peru.

II. Economic Situation and Trends

4. During the mid-seventies, the Peruvian economy went through a serious economic and financial crisis, which culminated in mid-1978 with the country on the verge of bankruptcy. The former Government's stabilization-cum-economic recovery program, supported by an international rescue effort (including an IMF standby, a $115 million program loan from the Bank and a major rescheduling of Peru's debt), resulted in an improved balance of payments performance in 1979. Peru's reemergence as a modest petroleum exporter and high world prices for its other exports further boosted the balance of payments. At the time of the change in Government, the country's external financial position was comfortable, the public finance situation had improved and economic recovery was underway with growth during 1979-80 in the 3-4 percent range.

5. Several acute short- and medium-term problems remain: (i) a high rate of inflation of over 70 percent p.a.; (ii) urban un- and underemployment estimated at 11.2 percent and 44.1 percent, respectively, of the urban labor force in 1979; (iii) stagnating agricultural production aggravated by a drought in 1980 that caused production to drop by 4 to 5 percent; (iv) high subsidies for food and petroleum products amounting to about 6 percent of GDP in 1980 (the public sector deficit was equivalent to about 5 percent of GDP in 1980); (v) a rigid structure of Government expenditures with high outlays for the uneconomic Majes irrigation/power scheme and over 50 percent allocated to interest payments and defense; and (vi) a stagnating petroleum production/exploration effort.

6. The Government also faces severe long-term problems such as widespread poverty, skewed income distribution, poor state of health and nutrition, rapid population growth, and severe water and land resource constraints.

7. President Belaunde has named a first rate economic team headed by Mr. Manuel Ulloa, who is both Prime Minister and Minister of Economy, Finance and Commerce. The team includes technocrats and leading personalities from Peru's private sector, many of whom were drawn from the ranks of international institutions (including the Bank) and from commercial banks. Minister Ulloa is the Bank's Governor for Peru and Mr. Pedro Pablo Kuczynski--the Minister of Energy and Mines and a former Bank/IFC staff member--is the Alternate Governor.

8. This team is committed to efficiency, decontrol, promotion of the private sector and to an equitable sharing of the benefits of growth. Policies are designed to promote trade liberalization, growth of exports, and employment generation while dampening inflation. Priority is given to the (i) revival of agriculture and industry; (ii) expansion of mining, power and petroleum production; (iii) rehabilitation and expansion of the country's transport system (a particular concern of President Belaunde); and (iv) improvement of health and housing.

9. In its first months in office the Government accelerated the devaluation of the sol to an annual rate roughly in line with the differential between domestic and international inflation. In January 1981, the Central Bank revised upwards Peru's interest rate structure. Deposit and lending rates were increased by about 20 percentage points. Taking into account commissions and discounting practices, the lending rate equals roughly 75 percent p.a. and is, therefore, positive. (The expected rate of inflation for 1981 is in the 60-65 percent range).

10. The public sector deficit is being tackled through periodic upward adjustments of food and petroleum prices and of water and power rates. These price increases are expected to lead to a reduction of the overall deficit to about 2.5 percent of GDP in 1981. Improvements in Peru's tax administration should help reach this manageable level.

11. All remaining non-tariff barriers to imports were eliminated in August 1980 and tariffs have been cut to an unweighted average of 34 percent. The previous Government's export tax credit scheme has been revised to eliminate abuses and an industrial promotion law is under preparation which would simplify the structure of incentives. These measures have contributed to the strong performance of manufactured exports, which rose from $330 million in 1978 to nearly $800 million in 1980. In the petroleum sector, to slow down domestic demand the Government has increased local prices for petroleum derivatives (the price of regular gasoline is about 90 ¢ per gallon). To maintain and expand oil exploration/production efforts, which currently enable the country to produce 200,000 b/d (70,000 b/d of which is exported), the Government has taken steps to improve the investment climate. Secondary recovery--previously the exclusive preserve of the State-owned oil company--is now open to private firms. The Government has also enacted a more favorable tax credit scheme. A number of international firms, including Shell, have reacted favorably to the new climate and appear ready to invest in Peru. In the related area of power generation, the Government is gearing up to expand the country's hydropower generation capacity. Delays in preparing future hydro projects, however, will require the Government to make substantial investments in thermal plants in the early and mid-eighties.

12. Assuming a continuation of these policies and given the country's resource base, we estimate that the Peruvian economy will experience growth of about 5 percent p.a. and have a manageable balance of payments situation through the mid-eighties. International reserves (currently at about $1.3 billion) would remain at a level roughly equivalent to 3-4 months of imports and Peru's debt service ratio would hover around 30 percent. The balance of payments may, however, deteriorate in the mid-eighties if the exportable surplus of oil declines.

III. Bank Relations

13. Beginning with the preparation of the 1979 program loan, Peru and the Bank have been engaged in a close and fruitful policy dialogue. Senior Bank staff have met with President Belaunde and his closest advisors to discuss Peru's economic situation and the Bank's role in its development effort. During these meetings, Mr. Belaunde has stated his preference for financing Peru's development, to the extent possible, with the help of donors like the Bank as well as his interest in technical support from the Bank. The policy dialogue has been furthered by the recent opening of a resident mission in Peru and by an economic mission in June/ July of 1980. Its findings served as the basis for an in-depth discussion with the economic team and will be published in April. The Bank has agreed to chair a Consultative Group meeting for Peru in the Spring of 1981.

14. While things could change (particularly if the economic team is replaced), there is at present broad agreement between the team and the Bank on most issues. Our dialogue has focussed, inter-alia, on the need for (i) continued regular price and exchange rate adjustments; (ii) an improvement in Peru's public investment program; (iii) restrictions on defense outlays; (iv) careful management of Peru's indebtedness, and (v) strengthening of energy planning.

15. The future Bank lending program is designed to (i) increase productive capacity, particularly in agriculture, mining and petroleum--which are the key to strengthening the balance of payments--and in industry, which can be an important source of employment generation; (ii) help meet the basic needs of the poor through health and rural/urban development projects; and (iii) help relieve serious infrastructure deficiencies, particularly in power and in transportation, where underinvestment and lack of maintenance is resulting in serious deterioration of existing roads. A major aim of Bank lending would also be to strengthen public sector institutions so that they can effectively prepare and carry out investments.

16. The Bank is considering an ambitious, but achievable, lending program of $1.2 billion for FY82-86, which would provide tangible backing to the economic team. The program's level would be reviewed in a year and revised upwards if management of the economy continues to be sound. About 23 percent of the FY82-86 program would be for socially oriented projects, 39 percent for productive activities and 38 percent for infrastructure. The proposed lending program for Peru dwarfs past lending to the country which totalled slightly less than $800 million through FY80. Efforts of the Bank's Lima Office in helping to identify prospective projects and in ensuring that preparation schedules are met should assist Peru and the Bank to meet the proposed targets. A marked improvement in the disbursement of our Peru operations also suggests that the country absorptive capacity would permit the proposed lending.

EMENA

Country Statements

ALGERIA

Basic Data

Population (1979)	:	18.3 m
GNP per capita (1979)	:	$1580
External debt (end 1980)	:	$15.8 b
Debt service ratio	:	21.0%
of which Bank share	:	1.2%

	Lending ($ million)			
	FY76-80	FY81	FY82	FY81-85
Bank	780.5	210.0	275.0	1244.0
	Number of Operations			
	14	2	7	25

Political and Economic Background

1. Algeria's economic, political and social structures have been profoundly influenced by the country's colonial history and its struggle for independence. The administration remains dominated by French bureaucratic structures and systems. While relations with France have gradually improved over the last few years, the Algerian attitude to France remains complex. Today, Algeria emphasizes its place in the Arab world and its role as a leader in the Third World. Internally, there has been a clear but very gradual movement towards liberalisation since the mid-1970's, with greater toleration of political dissent since the succession of the Chadli regime in 1978.

2. Partly as a result of the cut-off of trade by France following independence, an attempt was made to transform the structure of the economy, and a radical change has been effected. An agrarian-based economy has been transformed by massive industrialization and a basically free-market system has been replaced by highly centralized, socialist economic management. Massive investment in industry has been made possible by very high levels of domestic saving and low levels of consumption imposed by the Government. Algeria's economic achievements since independence would not have been possible without the enormous foreign exchange resources provided by its rapidly growing hydro-carbon (oil and natural gas) industry (average revenues $9 billion 1977-1980). Algeria has made great strides in some social sectors: e.g., illiteracy has been substantially reduced. However, housing is an area where much remains to be done, particularly in the urban areas.

3. While the change in the structure of the economy was profound, this was achieved at the cost of enormous economic inefficiency. Little attention was paid to the cost of industrialization or the effective use of investments once made. Overstaffing, poor management and lack of attention to financial objectives is prevalent. Agriculture was seriously neglected, with the growth of agricultural output hampered by organizational problems, lack of incentives for expanded production, and diseconomies of scale in the large socialized sector. Public enterprises which dominate the industrial sector have been

marked by low productivity, as a result of high excess capacity, poor management, difficulties in obtaining inputs, and absence of incentives.The economic structure has created powerful vested interest groups, which, in general, see little gain from improvements in economic efficiency. Individual ministries and enterprises have tended to become independent power bases, operating in isolation and, frequently, in opposition to each other.

4. Since 1975, and with increased impetus since the death of President Boumedienne in 1978, the beginnings of a change of emphasis in economic policy have emerged, with greater recognition of the need to improve economic efficiency, a slowdown of investment in industry, and a greater emphasis on agriculture and the social sectors, particularly housing. The policy of strict control on the growth of consumption is also being somewhat relaxed. These changes probably also reflect a growing disinclination of the younger generation of Algerians to accept either economic sacrifices or ideological explanations for poor economic performance.

Country Development Objectives

5. Algeria's third Development Plan, covering 1980-84, allocates more than US$ 104 billion for investment. The hydrocarbon sector continues to receive priority, but the proportion of investment in hydrocarbons is projected to decline, reflecting a new policy of conservation. Under this policy, hydrocarbon production will be limited to the level necessary to meet Algeria's external resource requirements while maintaining external borrowing at a level consistent with manageable debt service. The new Plan gives great emphasis to the social sectors (especially housing and water supply) and the need to improve economic efficiency and financial management.

6. The challenge for Algeria over the next decade or so is whether improvements in economic efficiency can be achieved sufficiently rapidly to meet growing aspirations, and, in the longer term, to permit continued economic independence when petroleum resources begin to be exhausted. While Algeria's development strategy appears to be sound, because of the complexity of the interests involved change is likely to be gradual.

Bank Objectives

7. The Bank's main country objective is to help improve economic planning and management, and specifically, to improve investment decision making and implemention through rigorous project preparation and appraisal, better monitoring of project execution and investment results, and reform and reorganization of the financial sector. The primary objective of sector work and lending (particularly in agriculture and the social sectors--education, urban development, water supply and sewerage), is to help introduce sectoral

policy and institutional improvements. Over the past three years, the first steps have been taken to broaden the scope of lending--hitherto largely confined to infrastructure and education--to the social sectors, and agriculture. A major role of the Bank has been to provide independent policy advice and the Government perceives its technical assistance function as the Bank's most valuable contribution to Algeria's development.

Status of Bank Country Relations and Main Issues

8. The Bank's relationship with Algeria has been a difficult one, although cordial at the working level. Until the late 1970's, the policy dialogue was disappointing, mainly because of a dogmatic approach to policy-making on the part of the Algerians. Since the recent change of Government, there has been very substantial improvement; progress has been made in gaining the confidence of senior officials, who now recognize the Bank as an impartial and constructive source of economic advice.

9. Algeria's performance in the implementation of projects has deteriorated seriously over the last two or three years. Despite signs of growing Government concern for improving efficiency, progress in achieving real improvement in implementation performance of Bank financed projects is bound to be slow. Deficiencies in project execution are due mainly to the slowness and fragmentation of decision taking which has become an even more serious constraint since the death of President Boumedienne; lengthy procurement procedures; and the inadequate capacity of the construction sector. An action program to improve project implementation performance, including twice-yearly project implementation reviews has been agreed recently. The Planning Ministry has also recently expressed willingness to cooperate more systematically with the Bank during the whole project cycle.

10. For the future, it is necessary for the Bank to respond flexibly to the evolving political and economic situation; to progress in improving performance under the existing portfolio and in the preparation of future projects for Bank financing; and to the Government's interest in reinforcing further the dialogue on economic policy issues.

EGYPT

Population (1979): 41 million

GNP per capita (1979): $460

External Debt
(end 1979): $11.3 billion

Debt Service Ratio
(FY80/81): 16.9%
of which Bank Share: 2.5%

	Lending ($ million)			
	FY76-80	FY81	FY82 1/	FY81-85 1/
Bank	906.5	145.0	479.0	2304.0
IDA	567.5	196.0	-	196.0
Total	1474.0	341.0	479.0	2500.0
	Number of Operations			
Bank	19	3	7	31
IDA	9	5	-	5

I. BACKGROUND AND RECENT ECONOMIC DEVELOPMENTS

1. The 1970's have been a period of transition from a centrally planned and relatively closed economy to the "Open Door" policy announced by President Sadat in 1974, and of gradual progress towards peace. Starting in 1975, Egypt reopened the Suez Canal and increased petroleum production, while workers' remittances and tourism became significant sources of foreign exchange. The contributions from these four sources increased from $1.1 billion in 1975 to $7 billion in 1980. On capital account, the cessation of Arab aid following the Camp David agreements was largely offset by a substantial increase in U.S. aid and direct foreign investment. As a result of these developments and a sustained high investment rate (close to 28 percent of GDP), the economy has experienced rapid growth in total output (close to 10 percent per year, 1975-1980) and a substantial improvement in the overall balance of payments, ($1 billion surplus in 1980). While the achievements appear impressive, they occurred mainly in sectors with weak linkages to agriculture, industry and services where the bulk of the labor force is occupied. Moreover, the long-run real growth potential for receipts from petroleum, Suez and remittances is uncertain. The challenge for Egypt lies in the necessity of channelling a good part of the surpluses and revenues from these "natural resource" based sectors, into productive investment in agriculture, industry and infrastructure so as to lay the foundations for self-sustaining growth and employment expansion in the domestic economy.

II. OPERATIONAL AND POLICY PROBLEMS

3. Pricing. Massive price distortions characterize the economy. For years Egypt was an economy with fixed prices where resource allocation

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1/ Size and composition as shown in initial draft CPP of March 11, 1981, which is different from program approved during Bank-wide allocation in April 1980 and amounting to $2,315m. including $950m. IDA. Change reflects current decision to stop IDA lending to Egypt in view of overall IDA constraint; but CPP proposes reinstating some IDA lending to achieve a more gradual phasing out.

decisions were centrally determined quite independently of financial profitability considerations. The increase in international inflation and domestic monetary expansion, the progressive devaluation of the pound and the "liberalization" of the economy would have required major adjustments in the structure and level of domestic prices over the last five years. Political and social considerations due, in part, to the memory of the January 1977 riots, have not allowed such adjustments. The gap between world prices and domestic prices of key traded commodities has increased, leading to large explicit (food) or implicit (energy) subsidies that constitute a heavy fiscal burden and lead to serious difficulties for resource and investment allocation decisions. What appears to be financially profitable may be economically ruinous and vice versa.

4. Creditworthiness and Medium-Term Balance of Payments While Egypt is very creditworthy in the short-run, the medium-term outlook is more uncertain. Existing proven reserves of petroleum are low in relation to annual production levels and domestic consumption is rising rapidly. The preservation of an exportable surplus is crucial for the medium-term balance of payments and depends on new discoveries of petroleum and/or natural gas and moderation in domestic consumption growth. The size and growth of Egypt's population, the uncertain prospects for petroleum and remittances, and the severe arable land constraint imply that sooner or later Egypt must become a significant exporter of industrial products.

5. Planning, Project Implementation and Public Sector Management Egypt has yet to come to grips with the problems of planning and project development. The Government's administrative and management structures continue to be weak and many departments are seriously taxed by the increasing level of project activity and donor assistance. The country has not yet developed a comprehensive system of national project review and within ministries there is little sectoral planning and project evaluation. These problems are exacerbated by the lack of coordination among the large number of ministries and agencies with overlapping responsibilities. Intentions to increase public sector efficiency through delegation of more authority to enterprises still await realization.

6. Income Distribution and Poverty While Egypt has been characterized by a remarkable degree of social peace and stability in a particularly unstable part of the world, periodically there have been signs of social tension, most recently in February/March 1980, when violent clashes took place between Copts and Muslims, and in September 1980, when a large increase in the price of sugar led to serious protests in the poorer sections of Cairo and was immediately reversed. While inequality is moderate by international standards, it is clear that liberalization has increased income disparities. The inability of some of the poorest segments of society to participate in the process of growth constitutes a serious problem for economic management.

III. BANK STRATEGY

7. Our strategy is conditioned by the above issues. We support Egypt's efforts (i) to further develop its natural resources and help

preserve the favorable overall resource balance, (ii) to develop the domestic non-oil economy by strengthening agricultural and industrial performance, and (iii) to meet the country's social obligations through investments and policy reforms addressing basic needs. In all these areas the Bank is in a good position to take the lead on sensitive issues and to provide continuing policy guidance. Accordingly, at the center of the Bank's strategy is an overriding consideration for economic policy reform, institution building, and improvement in sector policies and planning. It is very hard to predict in advance where economic reform will be able to overcome the political and psychological constraints it faces. Performance cannot easily be evaluated in terms of isolated components. In our discussions with the Egyptian authorities, we have agreed that partial policies are unlikely to be feasible on their own. For example, when raising energy prices to agriculture it will be necessary, simultaneously, to raise the prices farmers get for their crops. In turn, if these price increases are to be passed on to consumers, it would be reasonable to allow wage increases for those groups who bear the greatest burden of the price adjustments. The same kind of chain applies to energy (fuel oil, electricity, final products). As a general principle, we support any movement towards freeing the productive sphere of the economy from price distortions by shifting subsidies to the final consumer so that correct price signals are given to producers, and policymakers gain a clearer view as to who is being subsidized and to what extent.

IV BANK IMPACT AND COUNTRY RELATIONS

8. Until 1974, Bank involvement in Egypt was minimal. Since then, our involvement increased in financial terms from $40 million to over $400 million per annum. Since 1977 the Bank has also been chairing the Consultative Group meetings. Relations are cordial, the Bank's work is highly appreciated and the dialogue is on a high professional level, especially on macroeconomic issues. However, while the need for policy reforms is recognized by the Government, there is no sense of urgency in view of the currently favorable BOP situation, and there is reluctance to take decisive action for fear of adverse mass reactions. Therefore, while Bank involvement is helping keep the focus on crucial issues, progress in general is slow and impact through projects only gradual. It is essential that the Bank continues to press for gradual changes in a constructive way and work closely with Egyptian counterparts.

9. A special problem concerns IDA, which has constituted over 40 percent of our lending over the last few years. Given Egypt's currently comfortable balance of payments position, IDA credits are to be cut off from FY82, moving all our lending to IBRD. The Government is strongly resisting this abrupt elimination of all IDA. It has argued that it will not accept Bank lending for the financially softer social sectors (health, education, rural development, etc.). This may have an effect on both the sectoral composition of our lending to Egypt and in the short term may also affect the total level of lending (unless our involvement in other high priority sectors in which we are lending, can be increased).

MOROCCO

Basic Data			
Population	(1980)	:	19.5 m
GNP per capita	(1979)	:	$740
External debt (end 1980)		:	$7,117 m
Debt service ratio		:	22.3%
of which Bank share		:	8.0%

	Lending ($ million)			
	FY76-80	FY81	FY82	FY81-85
Bank	953.5	343.0	470.0	1540.0
	Number of Operations			
	22	6	7	28

Political and Economic Background

1. In the fifteen years following Independence in 1956, economic management in Morocco was conservative; investment and GDP growth were only modest, and external borrowing was very limited. Growing political tensions erupted in two attempts on the life of the King, the dominant force in Moroccan politics, in the early 1970s. Partly in response, economic management became more aggressive. Investment increased sharply and economic growth also accelerated. This tendency was accentuated with the rapid rise of phosphate prices in 1973, which more than offset the increase in the price of imported energy on which the Moroccan economy is almost wholly dependent. However, by 1975, investment reached a level which could not be sustained by domestic saving and prudent external borrowing. The price for phosphates collapsed, and prices for imported oil continued to rise. On top of this, Morocco found itself involved in a war in the Sahara, which rapidly became a heavy burden on the economy. The first response to these developments was to increase external borrowing sharply, largely through recourse to commercial funds. However, it soon became clear that the debt service burden was rising too rapidly, and, starting in 1978, civilian investment was cut back sharply and Morocco embarked on an interim three year stabilization plan.

2. While the austerity program managed to compress demand considerably, particularly as regards imports, growth in GNP also slowed substantially, resulting in intensified social and political pressures. Meanwhile, the Government has continued to rely on external borrowing to finance the balance of payments deficit. Debt service, which in 1975 represented only 5.6% of exports rose to 22% in 1980, and external debt outstanding rose to 40% of GDP.

3. In parallel with the economic developments summarized above, political and social changes were emerging. After a hiatus of almost a decade, in the mid-1970s political activity was resumed. In 1976, following the adoption of a Communal Charter, local elections were held for the first time. The following year an elected national parliament was re-established, although the King continued to dominate the politial system. As a direct

result, Governments since 1977 have been increasingly concerned to address the problems of poverty and unequal income distribution, which remain major issues in Morocco's development. Our assessment is that the King wishes to move--albeit gradually and cautiously--towards the establishment of a constitutional monarchy, relying upon democratic forces to gradually push Governments to address increasingly economic and social disparities. However, he can move only cautiously in this direction, since the powerful economic and social elite perceives democratization as a threat to their privileged position. Since the mid-1970s the King has skillfully used the war in the Sahara to rally all sections of the population behind him, and his standing with the mass of the population has improved very greatly.

4. The trend towards political liberalization and decentralization is expected to continue, and the 1982 national elections will probably increase public awareness of economic and social policy issues. Some recent signs have pointed to a possible resolution of the Sahara war in the near future; a lengthy protraction of the conflict could weaken current support for the King and threaten the incipient democratization process, as well as continue to drain budget resources.

Country Objectives

5. The Moroccan Government has recently prepared a new Five-Year Development Plan (1981-85) which is more optimistic in outlook than the retrenchment and austerity measures that characterized the 1978-80 Plan. The basic objectives of the Plan are to achieve changes in the structure of the economy to correct the imbalance in the external account, and to make further progress in addressing social issues. GNP is projected to grow at 6.5 % per annum. Emphasis is rightly placed on exports, the mobilization of domestic savings, resource-based or labor-intensive industry, rainfed agriculture and fisheries, development of domestic energy sources, and education and training.

Bank Strategy

6. Over the last few years, considerable progress has been made by the Government in improving management of the economy, in beginning structural change and in addressing social issues. Nevertheless, much remains to be done to achieve fundamental changes in the structure of the economy, and to address the problems of poverty. The Bank's strategy is to support efforts in these two main areas.

7. Improved management of the economy and implementation of structural changes, particularly to encourage exports, reduce imports, and increase savings, are being addressed through the economic and sector work program, through project lending, particularly in the productive sector, and, more recently, through structural adjustment lending. A first structural adjustment loan is now at an advanced stage of preparation, and two further loans are planned for FY82 and FY84.

8. It is however important that concern with short-term balance of payments and resource constraint issues not distract the Government or the Bank from the long-term objective of improving the distribution of income and basic human needs. Indeed, in Morocco, efforts to improve the welfare of low income groups may also represent the most effective way of contributing to increased growth of the economy--for example through emphasis on rainfed agriculture or employment generation. Many of the Bank-supported projects in Morocco are wholly or partially aimed at developing more cost-effective delivery systems for basic social services and economic infrastructure. This approach, which focuses on a more appropriate technology, local participation and consequent lower unit costs, should allow the Government to increase its outreach to previously neglected groups and regions. Nonetheless poverty-oriented programs are administratively complex and human-resource intensive, and are more difficult to prepare and implement then projects in traditional sectors.

The Bank's Relationship

9. Relations between the Bank and Morocco are excellent. At the working level cordial relationships and close collaboration have been facilitated by the Prime Minister's office which coordinates contacts with the Bank. Morocco looks to the Bank both for substantial financing to meet its external requirements, which will continue to be large and growing for the foreseeable future, and for advice on economic policy issues. Preparation of a basic economic report, of the first structural adjustment loan and of important sector reports in industry, agriculture, water supply and transportation have all acted as vehicles for intensifying the policy dialogue.

ROMANIA

Basic Data				Lending ($ million)			
				FY76-80	FY81	FY82	FY81-85
Population (1979)	:	21.9 mln	Bank	1192.6	360.0	290.0	1625.0
GNP per capita (1980)	:	$1,900					
External Debt (1979)	:	$5.6 bln					
Debt service ratio	:	12.3%		Number of Operations			
of which Bank Share	:	4.5%	Bank	20	4	4	23

A. Political and Economic Characteristics

1. Salient Features. Romania is the Bank's only East European member which also belongs to the Council for Mutual Economic Assistance (CMEA). Its economy is centrally planned along orthodox marxist lines with a controlled centralized system which is totally dominated by Romania's Communist Party headed by Nicolae Ceausescu.

2. Economic Performance. Over the past three decades, Romania has pursued a development strategy designed to industrialize a primarily agrarian economy. Its economic development has been impressive, characterized by rapid economic growth based on high investment rates (averaging about 33 percent of GNP over the 1976-80 plan period), especially in industry which is now the leading sector in the economy. In the course of industrialization, a wide range of technological skills have been developed; consumption has necessarily been held down.

3. Economic Prospects. Emerging internal and external constraints on development will tend to limit the future performance of the Romanian economy. In the drive to rapidly industrialize, the economy has become more dependent upon imported raw materials and, at least temporarily, on energy. This has caused a deterioration in the balance of payments. Export performance needs to be improved and energy conservation pursued if Romania is to rectify this situation. The Romanian authorities recognize this and have initiated measures in this respect. They have also acknowledged the need to provide consumers a greater share of development benefits linked to the need for greater material incentives to increase productivity. The share of investment in GNP for the next plan period, 1981-85 is, therefore, planned to decline to 30%.

B. Relations with Bank and Main Issues

1. Brief History. Romania joined the Bank in 1972 and was mainly motivated to do so to gain access to Bank funds. The Bank's principal objective is to assist in supplying the much needed foreign exchange linked, where possible, to inputs of high technology. Romania, however, has been

suspicious of Bank motives, and has been unwilling to share information, although there has been much relaxation in this respect recently. Strong initial opposition to conditions attached to project loans has been toned down as it has become more familiar with Bank objectives. Romania's technical expertise has permitted the development of a strong project pipeline as these difficulties are gradually being overcome. As such we now have sufficient project vehicles to transfer more resources than allocated in the existing lending program.

2. Main Current Issues. The size of the lending program is constrained partly by the attitude of Executive Directors and is also linked to the question of graduation. Another matter on which the Government has procrastinated is the finalization of its preliminary agreement to join IDA, in spite of urgings by senior management of the Bank. This delay may be due to Romania's present severe balance of payments difficulties. Provision of information is a much less acute issue than formerly, but there are still some problems in readily acquiring macro economic and sector data in sensitive sectors.

3. Project Implementation. Implementation of projects is generally good but is characterized by two common problems. There are delays in production and delivery of locally manufactured equipment for Bank assisted projects and procurement problems.

C. Impact of Bank Activities

Given Romania's relatively advanced stage of economic and institutional development combined with the particular nature of its centrally controlled system and the inevitable limitations in our relationship, the Bank can have little influence on strategic macro-development issues. However, with closer relationships gradually developing over time, we have been able to make a significant impact in project design and in subsector policy and program issues (e.g. chemicals and steel). We have also been able to assist Romania in securing substantial amounts of cofinancing for projects in which the Bank has participated. To date about $500 million has been raised in the last two calendar years, compared with total Bank lending of $860 million over the same period.

TURKEY

Basic Data		
Population	(1980)	: 45 mln
GNP per capita	(1980)	: $1200
External debt	(1980)	: $16.6 bln
Debt service ratio	(mid 1980):	36.7%
of which Bank share		: 6.9%

	Lending ($ million)			
	FY76-80	FY81	FY82	FY81-85
Bank	1498.0	707.8	540.0	2675.0
	Number of Operations			
	21	8	7	36

Economic and Political Background

1. Turkey has faced a difficult political adjustment process ever since Ataturk led national reconstruction after the collapse of the Ottoman Empire following World War I, and the establishment of the Republic. During the first period of forced westernization, deep cultural and social changes took place, but particularisms were muted by the State's determination to forge a nation with sufficient internal cohesion and strength to resist further dislocation. This effort was largely successful. In the following period, starting in 1955, the transition to democracy won a wide national consensus, but allowed the divisions in the body politic to come to the fore. Two main trends emerged, opposing modernism against traditionalism and etatism against free enterprise. The shift from an agrarian society to a largely urbanized one compounded these differences. The parliamentarian system of government and proportional representation proved ill suited to resolve conflicts between parties and classes. As a result, political instability (and, in recent years, terrorism) prevailed and the Army intervened three times (1960, 1971, 1980) to suspend constitutional government and preserve what it considers to be Ataturk's legacy.

2. The economic policies consistently followed by different governments until 1980 aimed chiefly at establishing Turkey as an industrial power rather than at developing a balanced economy. This involved a large expansion of public and private industry, mostly for import substitution with high protection, and little regard for productivity and external competitiveness. Concurrently, although substantial progress was achieved on basic needs, no coherent policies on employment and urbanization were developed while the population doubled since 1950 and nearly half of it lived in cities in 1980. Nevertheless, a creditable record of GNP growth per capita was scored (4.5% in 1970-77), but the strategy followed compounded structural imbalances and made Turkey vulnerable to the external crisis of the 1970's owing to its large dependence on imported energy. Short-term external borrowings in 1976-77 impaired Turkey's creditworthiness and led to a large debt burden which may well take a decade or more to resorb through rescheduling and the expansion of exports.

3. The intervention of the Army in September 1980 has checked Government paralysis and terrorism. The drastic economic stabilization measures and shift to a market economy initiated by the preceding Government in January 1980 have been pursued and expanded, especially for the ailing State Economic Enterprises (SEEs). The Army may need quite some time to reach its dual goal of restoring a sound economy and elaborating a workable constitution. It is doubtful that it would want to restore constitutional rule until the acute political divisions and economic problems have a chance to be brought under control, despite external pressures for the return to democracy.

Country Objectives and Issues

4. Turkey's current crisis can be explained by a failure of economic management responses to deal with external developments (oil prices, stagflation in OECD, closing of labor market in Europe, rampant inflation) and by a longer-standing failure of economic policies and strategy. Over the past year, the Government has dealt with some success with the first set of issues (except unemployment). It still has to pursue the sustained efforts needed to correct more fundamental problems.

5. Policy making will remain a major issue as long as there is no commitment from the major political parties and among the makers of opinion to objectively analyze the causes of Turkey's crisis (the responsibility for which is widely shared). In particular, the inward-looking orientation of most past Governments, the importance given to growth over equilibrium, the neglect of employment and exports, and the expansion of an inefficient civil service and public sector, reflect deep-rooted attitudes, which institutional changes alone cannot correct. The present Government has mapped a comprehensive reform program and is implementing it in stages. Its main features are as follows:

(a) Balance of payments: flexible exchange rate, export promotion policies, liberalization of imports.

(b) Public finance: progressive reduction of budget deficit, tax reform, freeing of most SEE prices and curtailing financing of SEEs from the Budget and the Central Bank.

(c) Public investment: drastic reduction of investment level, adoption of economic criteria.

(d) Resource mobilization: reduction of subsidies, freeing most interest rates.

6. The measures already taken are starting to bear fruit and appear to be accepted by a majority of the people despite the sacrifices they require in a situation where inflation and unemployment hurt large segments of the population. They have justified support from the IMF, the Bank and OECD countries, thus easing the pressure on the balance of payments. Further actions have been agreed with the IMF and (in connection with structural

adjustment lending) with the Bank. While they will continue and consolidate the economic policies outlined above, much more detailed measures were decided upon recently as regards: (a) supply-side policies (public investment, energy and agriculture); and (b) SEEs (depoliticization and autonomy of management, freeze in recruitment, increasing subjection to market forces, and plans for fundamental reform of their legal framework).

7. Despite the courageous measures taken so far, three issues are likely to remain of major concern in coming years. Import requirements and exports potential have little elasticity, whatever the measures taken; a continued inflow of external funds (on concessional terms) will therefore remain crucial to Turkey's recovery until its creditworthiness is restored to the point where it can resort to commercial lending. Resource mobilization will continue to face the constraints of inflation (for the private sector) and inefficiency (for the public sector); improvements in this field can only be gradual. Last but not least, unemployment is likely to worsen because of reduced investments and an over-inflated service sector (except in tourism). Overall, the road to recovery is likely to be a long and difficult one.

Bank Objectives and Strategy

8. The Bank's relations with Turkey have gone through three phases. Before 1970, limited creditworthiness and resistance to external advice and led to a tenuous relationship and little lending. After the 1970 stabilization program, the Government sought Bank assistance in a large number of sectors. The dialogue on economic policies culminated with a basic economic report (1974). Sectoral issues were studied on a broad front and lending increased substantially. However, political instability, lack of decisions on policy issues and poor project implementation led to gradual retrenchment; as a result, we had to discontinue lending in key sectors (urbanization, education, irrigation, railways). The 1977 payments crisis called for a reassessment of the relationship (by both sides) and of priorities for Bank activities. Resumed lending on a large scale led to a much closer and confident partnership with the successive Governments. Immediate objectives were dealt with program/structural adjustment loans. Longer term ones were revised in light of our (and the Government's) analysis of Turkey's structural problems.

9. Our lending strategy, based on focused economic and sector work, aims to support the restructuring of the economy and resumption of a viable rate of growth in the 80s. Structural adjustment and project lending (together averaging $600 million annually), aims to alleviate the large balance of payments deficit which must be anticipated over the next five years. The basic thrust of the projects we support should be: (a) support for private sector initiatives in export-oriented and employment generative agriculture and industrial areas; (b) development of oil, gas, coal, lignite, and mini-hydro resources; (c) improved management and financial viability of key state economic enterprises; (d) rationalization and modernization of installed capacity, rather than large new projects; and (e) elimination of infrastructural bottlenecks to growth.

10. We face, and expect, continuing difficulties in the preparation and implementation of projects. The scarcity of local currency and foreign exchange resources to cover rising costs of even priority projects, shortage of middle-level managers, lack of sufficient skills to prepare new projects thoroughly, and a hierarchial public service which takes decisions and actions slowly, will all continue to bedevil our portfolio, despite Turkish goodwill and resolve which is now increasingly evident.

YUGOSLAVIA

Basic Data

Population (1979)	:	22.1 mln
GNP per capita (1979)	:	$2,430
External Debt (Sept. 1980)	:	$16 bln
Debt service ratio (1980)	:	19%
of which Bank share	:	6.5%

	Lending ($ million)			
	FY76-80	FY81	FY82	FY81-85
Bank	1,542.0	321.0	345.0	1,831.0
	Number of Operations			
	26	4	5	24

1. Economic and Political Background and Economic Management

Since the death of Tito the interlocking collective leaderships of the League of Communists and the State Presidency have provided an effective framework for building political consensus among Yugoslavia's ethnically and economically diverse and highly independent constituent republics and provinces. The new leadership quickly established its political authority and was able to secure widespread public support for a tough stabilization program soon after taking office. Economic policy making is based on a unique system of workers' self-management which permits regional autonomy while maintaining the ideological unity of the country. The economy has achieved a rapid rate of economic growth--averaging 6 percent during 1953-79--while promoting regional development through high levels of interregional resource transfer; but growth has been cyclical because of the weakness of the macroeconomic policy framework. A lackluster export performance in the seventies, coupled with a surge in oil prices, culminated in a severe balance of payments crisis in 1979. In response a phase of adjustment and retrenchment has been introduced for the medium term, with relatively slower growth (4.5 percent) targeted in the 1981-85 draft five-year plan.

2. Country Development Objectives and Strategy

Yugoslavia's fundamental objectives are to build a rising standard of living for its citizens; more even levels of regional development; balanced trading links with both the Soviet Union and the West; and, finally, a form of economic organization which ensures genuine participation for its workers in economic decision-making.

The major external problems facing the country are the need to enhance export competitiveness in convertible currency markets and improve its access to the external capital markets. In the domestic market, the country has to raise the efficiency of its investment program and strike a more careful balance between projects which serve regional development objectives and the need to avoid duplication of capacity and promote national efficiency.

3. Objectives of Bank Group Lending and Impact

Although Yugoslavia is a "high income" country that has achieved a rapid rate of economic growth over the past quarter of a century in many areas this growth has been uneven. Although the Republics of Bosnia, Macedonia, Montenegro and the Autonomous Province of Kosovo are recognized as less developed regions (LDRs) substantial pockets of underdevelopment exist even in the more highly developed Republics/Provinces. The objective of Bank lending has been and continues to be the support of the government policies aimed at reducing these disparities.

Over the last five years about two-thirds of Bank lending to Yugoslavia has been channelled to the LDRs. About 75% of this lending has been aimed at strengthening the agricultural sector, with emphasis on the low income private sector, and industrial development emphasizing projects which provide low cost employment creation and export oriented industry. Bank funds provided to the more developed regions have been largely in the form of projects with a national or international orientation such as the Trans-Yugoslavia Highway, Railways and Power Transmission. The direction of funds to the LDRs has required manpower inputs consistent with those required in many of the Bank's less developed borrowing countries, further aggravated by Yugoslavia's unique but complicated autonomous system of self-management.

It is envisaged that continued Bank lending to Yugoslavia will be even further concentrated in the LDRs, particularly for agriculture and the low income private sector.

Although Yugoslavia is mentioned as a candidate for phase-out of Bank lending, continued lending on a substantial scale is considered vital not only for alleviating the current critical foreign exchange shortages but, in particular to encourage and improve access to capital markets through cofinancing. Cessation or drastic reduction of Bank lending would be regarded as a highly negative factor by the capital markets. Cofinancing arrangements in the amount of $560 million have been made over the last five years in connection with Bank financed projects and it is hoped that this will continue in spite of the strategy of increasing lending for private sector agriculture which is less attractive to the financial markets.

Since Yugoslavia is dependent upon imports for about 40% of its energy requirements the Bank should support its efforts to develop the plentiful domestic resources which are substantially underdeveloped. While Bank resources are limited, Yugoslavia should qualify for substantial assistance if and when the proposed Energy Affiliate is established. Yugoslavia is seeking financial assistance in the development of its ample underdeveloped coal reserves and hydro capacity. The proposal for a Bank Energy Sector Study is currently being reviewed by the authorities.

4. Country Relations and Issues

Yugoslavia's relationship with the Bank continues to be excellent and is not limited to lending operations. Yugoslavia has traditionally supported the Bank and Bank initiatives in many international fora. It has consistently contributed to and supported IDA and has made significant purchases of Bank notes and bonds. The Bank's economic and sector work is valued as an independent commentary on the unique Yugoslav system, which sometimes bewilders some international observers.

Notwithstanding the exaggerated international media prognostications of possible disintegration of the Republic following the death of Tito, Yugoslavia's government has maintained a high level of national integrity for the first post-Tito year. No dominant leader or political faction has emerged. However the situation should continue to be carefully monitored since the next year or two could be crucial, particularly if the current economic difficulties should encourage the development of regional or radical factions.