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Mr QURESHI'S
OPERATIONS CMTE

June 1987- January 1988

January 25,1988

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 20, 1988

TO: Operations Committee

FROM: EG Enzo Grilli, Acting Director, EAS

EXT: 78061/2

SUBJECT: GUATEMALA - Country Strategy Paper - Agenda

1. The Operations Committee will meet on Monday, January 25, 1988 at 5:00 p.m. (instead of 4:00 p.m.) in Room E-1244 to discuss the CSP for Guatemala.

2. Since the last CPP in 1984, there has been considerable political and economic change in Guatemala. The current Government initiated a "stabilization-cum-adjustment" program in June 1986, which has thus far produced some notable measures, for example, a tax reform bill in 1987. Current account and fiscal deficits have come down, real interest rates have become positive, and the inflation rate has also been contained.

3. In view of the improved performance and prospects, the CSP presents the option of doubling the lending program during FY88-92. Instead of the six investment operations during the last 5 years, we will have 12, four of which will be SECALs. Instead of lending $217 million, we will lend $455 million. This expansion will maintain net transfers and net disbursements at positive levels. The basic issue is whether the lending program should be, or can be, doubled, and if so what its thrust and composition should be. With this in mind, the Committee might wish to discuss the following issues.

Macroeconomic Policies and Creditworthiness

4. Thus far the new Government has shown a strong commitment to stability. The main questions concern its willingness and ability to continue or start key reforms for adjustment and growth, especially in the areas of trade and exchange rates, financial policies, public expenditure programs, and agriculture. The Region might explain:

- the status of discussions with the IMF. Stand-by discussions have been in process intermittently for over a year.

- the status of our Export Development Project. This project was appraised about a year ago, but we have not yet received indications that the Government is ready to produce a satisfactory Letter of Development Policy. Which conditionalities are the major sticking points? Are there significant changes in the conditionalities since the Yellow Cover was discussed by the Loan Committee in April 1987? Is there a basic agreement in principle that this operation would be the first step towards the eventual goal of having only minimal trade interventions?

- public finance. There is no provision in the Economic and Sector Work plans for annual public sector expenditure reviews. Would not such reviews be extremely desirable for helping the Government maintain fiscal balance while expanding expenditures on both social and infrastructure sectors?

- domestic savings. A related issue is the realism of our assumption that domestic savings can be increased very substantially and fast. How firm is this judgment? How sensitive are the projected external capital requirements to the savings forecast?

Lending Program and ESW

5. The main issues concern absorptive capacity, sectoral composition and the adequacy of planned ESW:

- absorptive capacity. The record on absorptive capacity for investment loans is not encouraging (paragraph 25 in the CSP). What explains the long delays in signing the water and power loans? Inasmuch as the delays are due to such matters as tariff, are we not being too optimistic in assuming we can deliver the eight investment loans as scheduled?

- policy loans, ESW and follow-up. The capacity to design and implement four policy loans during this period can also be questioned. Although no indication is given in the CSP of the amount of ESW resources to be used, it seems that we intend to rely mainly on loan preparation work. Will this be enough? Also, since the policy reform process takes much longer than the life of a policy loan, will we not need follow-ups to the Export Development Project?

- the weight given to agriculture. From the point of view of both growth and poverty redressal, the agriculture sector has a key role to play in the Guatemalan economy. Yet the core program includes only a Secondary Roads operation in FY89. While the broader program does include a SECAL in FY91, the question remains as to whether the proposed level of lending is proportionate to the relative importance of the sector. Would it not be better to focus on agricultural policy reforms as soon as possible?

cc: Messrs. Lee, COD; Dubey (o/r), EAS; Shakow, SPR; Holsen, CEC; Rao, FRS; Baneth, IEC; Thahane/Burmester, SEC; Liebenthal, SPR; Steer, FRS; Baudon, SVPOP; Steckhan, Selowsky, Corbo, Derbez, Park, Marques, LAC.

For Information Only

cc: Messrs. Fischer, VPDEC; Bock, DFA; Stanton, VPEXT; Frank, Parmar, IFC; Hopper, PPR; (Ms.) Haug, EXC; Goldberg, VPLEG; Agarwala, VPAFR.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE : January 21, 1988

TO : Operations Committee

FROM : EG Enzo Grilli, Acting Director, EAS

SUBJECT: Madagascar: Public Sector Adjustment Credit - OC Meeting Agenda

1. The Operations Committee will meet on Monday, January 25, 1988 at 4:00 p.m. in Room E-1244 to discuss the Initiating Memorandum (IM) dated January 15, 1988, for a proposed Public Sector Adjustment Credit (PSAC) to Madagascar for $85 million. The PSAC would be the fourth adjustment credit to Madagascar, following two sector adjustment credits in 1985 and 1986, and a broader-based Industry and Trade Policy Adjustment Credit in 1987.

Background

2. Following modest economic growth from independence in 1960 to 1972, the Malagasy economy experienced stagnation from 1972 to 1980, sharp deterioration from 1980 to 1982, and financial stabilization with marginal growth from 1983 to date. The poor economic performance of the 1970's stemmed largely from inappropriate economic policies introduced after 1972, including nationalization of foreign-owned enterprises, state-directed industrialization, pervasive controls on private economic activity, and extensive consumer subsidies. However, cautious monetary and fiscal policies remained in effect until 1977, and debt-service remained low. Between 1978 and 1980, the government embarked on an ill-advised public-investment program that led to a doubling of imports and unsustainable fiscal and balance of payments deficits, and dramatically increased debt service burdens. Stabilization measures were introduced in 1981, with IMF assistance, leading to a significant improvement of the fiscal balance by 1984. Strong external adjustment measures were introduced during 1984-87. Starting in 1985, but especially since 1987, measures have been introduced to reorient the economy toward market incentives.

3. The proposed PSAC would support the next phase of the adjustment process. The proposed program would complete the process of external trade liberalization, continue with reform measures in the parastatal and financial sectors, and extend the programs to reforms in public expenditure and social areas.

4. The Committee may wish to discuss the following:

(a) The lack of specific and monitorable performance targets.

Apart from specific targets already covered by IMF operations and previous adjustment credits (e.g. ceilings on credit to poorly performing public enterprises), there are very few specific and monitorable performance targets included. Most of the proposed measures, e.g., "Agreement on the 3-year 1989-91 PIP and on the 1989 PEP" leave performance evaluation almost completely to undefined staff judgements. There are only very few (and relatively unimportant) specific measures included, such as "comprehensive census of the civil service", or "full domestic and external liberalization of pepper marketing".

(b) Agricultural Exports.

While coffee, vanilla and cloves continue to account for two-thirds of total exports, no changes in the state export marketing monopoly are being considered at present. Only internal marketing liberalization is proposed for these commodities. Is trade liberalization meaningful if two-thirds of exports remain under a state monopoly?

(c) Public Enterprises.

Very little is said in the IM on specific measures to be taken with respect to the large number of poorly performing state enterprises. Specific measures include only liquidation of five small state enterprises. All other measures are vaguely worded e.g. "Satisfactory progress on the implementation of the PE rehabilitation/diverstiture process". What is "satisfactory progress"? Would it not be time to get a more specific commitment such as divestiture of all state enterprises in the manufacturing sector?

(d) Financial Sector

The classical IMF approach to economic stabilization (credit ceilings etc.), while appropriate during the initial stabilization period, now runs the risk of conflicting with economic reform objectives, and particularly a larger role of market forces in the financial sector. How does the Region propose to deal with this issue?

(e) Release of the Third Tranche of ITPAC.

The Government has expressed an interest in advancing full import liberalization by a few months, and has asked for early release of the Third Tranche (US$34) of the Industrial and Trade Policy Adjustment Loan (ITPAC). The Region proposes to incorporate remaining ITPAC conditionality that could not be implemented on the accelerated calendar into the PSAC. Is this warranted? How will IMF ceilings affect this increased availability of foreign exchange to the private sector?

cc: Messrs. Lee, COD; Dubey, EAS; Shakow, SPR; Holsen, CEC; Rao, FRS; Baneth, IEC; Thahane/Burmester, SEC; Liebenthal, SPR; Steer, FRS; Baudon, SVPOP; O'Brien, Denning, Ohri, Armstrong, AFT; Isenman, Gorjestani, Varon, Capoluongo, Devaux, Pasquier, Gervais, Bui-Quang, AF3CO; Penalver, Schmidt, AF3IE; Colliou, Blay, Castadot, De Gaiffier, AF3PH; Blanc, Bostrom, AF3IN; M. Long, W. Steel, PPR; R. Picciotto, PBD; Peloschek, LEG; Renkewitz, AFTIN; Bronfman, RMM; Schiavo-Campo, AF3CO, Siraj, COD.

Mesdames M. Alexander, Torabi, AFT; Hill, Ibrahim, AF3CO; Kalantzopoulos, Garrity, AF3IE.

For information only:

Fischer, VPDEC; Bock, DFA; Frank, Parmar, IFC; Hopper, PPR;
Boldberg, VPLEG; Agarwala, VPAFR; Haug, EXC.

GPohl:pl

January 13, 1988

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The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee to Consider KENYA - Industrial Sector Adjustment Credit

CONFIDENTIAL

Held on January 13, 1988 in Room E-1244

A. Present

Committee

Messrs. M. Qureshi (Chairman)
S. Husain (LACVP)
S. Fischer (VPDEC)
W. Thalwitz (EMNVP)
C. Madavo (AF2DR)
D. Rao (FRS)

Others

H. Vergin (SVPDR)
T. Baudon (SVPOP)
E. Grilli (EAS)
R. Liebenthal (SPRPA)
E. Adu (LEGAF)
S. Ettinger (CODOP)
K. Amoako (AF2CO)
H. Wackman (AF21E)
S. Lateef (AF2CO)
N. Calika (IMF)
F. Chaudhri (EAS)

B. Issues

1. The meeting was called to discuss the proposal in Mr. Jaycox's memorandum of January 5, 1988 for an Industrial Sector Adjustment Credit (ISAC) to Kenya for US 107 Million (US $77 million IDA and US $30 million SFA). The discussion covered the main issues raised in the EAS's memorandum of January 11, 1988 and some other points. The major focus was on the scope of the proposed operation, macro-economic issues including the exchange rate policy, import liberalization, administrative and institutional capacity, and the social cost of the adjustment process.

C. Discussion

General

2. The first broad question raised by the Chairman related to the Bank's SALs in the past and the proposed operation: "are not we asking Kenya to do the same they should have done in the past and providing them more money to do that?" The Region's response was that the analytical basis of the work underpinning the previous SALs was weak, the pace of reform was not realistic and a broad consensus in the country was missing -- all of which resulted in a less than satisfactory progress on SALs. Now that the policymakers team is a different one, ongoing adjustment process in the agriculture sector is quite

satisfactory and the analytical work and consensus among the technocrats have progressed very well, the Region felt more confident on the expected outcome of the proposed operation. The Chairman accepted the response and the general case for the proposed operation.

Scope of the Operation

3. The first point on the Agenda regarding the dispersion and multiplicity of objectives and measure was taken up for discussion and the question was asked, "why start on a broad front and why could not certain financial sector aspects be deleted?" The Region felt that in their judgement the issues of monetary policy were included in order to reinforce the import liberalization measures; some DFI reforms were included to ensure the availability of credit for restructuring and stockmarket strengthening was envisaged to encourage widespread ownership. Consequently, the Region felt that the operation as proposed was an integral whole.

Macro-Economic and Exchange Rate Issues

4. Several questions were raised on the degree of restricted items in total imports, quantitative restrictions and there impact on the exchange rate and the rent they create; working of the import licensing mechanism; and terms of trade and their effect on the macro-economic framework. The response was that Kenya has been following a flexible exchange rate policy -- there was some 25% devaluation in real terms since 1985 and more recently during July - November, 1987, the currency was devalued by about 8%. The Region further stated, that the country could not take a more bold approach to the dismantling of quantitative restrictions (QRs) because it is not confident that benefits from such a move would be commensurate with the risks particularly because of the low level of foreign exchange reserves. The Chairman strongly suggested that it was: (i) very important to push for liberalization within the limits of the foreign exchange availibility, and (ii) necessary to get as much up-front action on QRs and other points as possible. The Region agreed to try their best in seeking these assurances and actions from the government. In response to a related question on the impact of the terms of trade (TOT) on foreign exchange earnings, the Region felt that both export expansion and improvement in TOT were expected to enhance the availability of foreign exchange but if the expected improvement in TOT did not materalize then the government would have to concentrate on improving the foreign exchange management. The Chairman stressed that it was important for Kenya to pursue the foreign exchange and other supporting policies actively to support the liberalization process.

Administrative and Institutional Capability

5. In response to the issue of administrative capacity raised in the Agenda, the Region felt that the Treasury has an ongoing technical assistance program and can handle the import program very well. Similarly the Central Bank is well equipped and there is no dearth of technical assistance from bilateral resources. The Region is, however, concerned that the Ministry of Commerce which handles exports is definitely weak and needs technical assistance to

accomplish their task satisfactorily. The proposed appraisal mission will look into the ministry's requirements in this area.

Social Costs of the Adjustment Process

6. The Region's general feeling was that price decontrols and other adjustment measures might not have much adverse effects on certain groups. The Chairman, however, stressed the need to address this issue because it was important to ameliorate any hardships in the short-term that are likely to surface as the adjustment process unfolds.

Commercial Borrowings

7. One participant referred to a hint in the draft CSP to the effect that if the country did not get enough funds from commercial resources then it could borrow commercially. The Chairman stressed that the Region should actively discourage Kenya from borrowing commercially at this stage because it would generate more problems than it would solve.

D. Conclusion

8. Subject to the modifications suggested above, the Committee authorized the Region to appraise the proposed Industrial Sector Adjustment Credit to Kenya.

FChaudhri/mb

January 20, 1988

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The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee to Consider
MALAWI - Industrial and Trade Adjustment Credit
Initiating Memorandum

CONFIDENTIAL

Held on January 13, 1988 in Conference Room E-1244

A. Present

Committee	Others
Messrs. M. Qureshi (Chairman)	Messrs. S. Sandstrom (AF6DR)
E. Jaycox (AFRVP)	E. Grilli (EAS)
S. Fischer (VPDEC)	T. Baudon (SVPOP)
W. Thalwitz (EMNVP)	P. Belli (AF61E)
H. Scott (LEG)	S. Ettinger (CODOP)
D. Rao (FRS)	F. King (AF6CO)
	R. Liebenthal (SPRPA)
	H. Messenger (AF6CO)
	S. Rajapatirana (EAS)
	R. Scobey (AF6CO)
	A. Zerabruk (LEGAF)

B. Issues

1. The Operations Committee met on January 13, 1988 to discuss the initiating memorandum (IM) for a proposed $60 million credit to Malawi. The discussion broadly followed the agenda prepared by the Economic Advisory Staff which raised issues relating to the suitability of the Credit to address the macroeconomic situation, implementation of the credit, the foreign exchange allocation system and the sequencing of the proposed reforms.

2. On issues relating to the macroeconomic situation, the region explained that the credit is designed within the context of an IMF stand-by. Fiscal, monetary and exchange rate concerns are to be addressed in the context of the stand-by and in the preparation of a policy framework paper in concurrence with the government and jointly with the Bank and the Fund. The fiscal deficit in the near term is to be reduced to 7-8% of nominal GDP and the exchange rate adjusted to about the level that prevailed in 1978. The Committee suggested to the Region to aim at a lower deficit and one consistent with exchange rate action. It also suggested that the conditions of the credit reflect an agreed timetable for specific action both on the levels of revenue and expenditure; and the composition of expenditures based on the public expenditure review currently under preparation.

3. On the implementation issue, the Region explained that this credit follows a number of earlier efforts to improve public administration. These efforts have included technical assistance to improve public sector management and the reform of tax laws. In addition the Region is in the process of developing methodology for expenditure control in the connection with a public expenditure study. The Malawi civil service is competent and up to the task.

4. The main thrust of the reform of the foreign exchange allocation system is to provide access to industrial raw materials and spare parts for the industrial sector on the same basis as for the agricultural sector. The Region was aware of the possibility of increasing effective protection for some activities in the process of the reform, but in the phasing of the reforms they will attempt to minimize it.

5. On the issue of sequencing of the reforms, the Region agreed that the sequence will begin with reducing the fiscal deficit to contain excess demand. This will be followed by exchange rate action consistent with the fiscal deficit. Trade reforms will be implemented with fiscal and exchange rate actions in place.

6. At the conclusion of the discussion, the Committee made a number of suggestions: (i) introduce conditionality on a specific timetable for fiscal reforms on the revenue as well as the expenditure side including the composition of expenditures, (ii) provide explicit conditions for second tranche release such as the agreement on further reduction of the fiscal deficit, (iii) attempt to speed up the timetable for trade reforms in the discussions with the government; and (iv) provide the Committee revised projections to indicate the fiscal deficit, the financing gap and sources of financing that have been agreed with the government in preparing a Policy Frame-work Paper. The Region agreed to these suggestions.

C. Conclusion

7. The Region was authorized to proceed along the lines proposed in the Initiating Memorandum and subject to the discussion summarized above.

SRAJAPATIRANA/mb

January 20, 1988

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 6, 1988

TO: Operations Committee

FROM: Enzo Grilli, Acting Director, EAS

EXT: 78061

SUBJECT: KENYA - Initiating Memorandum for the Proposed Industrial Sector Adjustment Credit

The Kenya Initiating Memorandum for the Industrial Sector Adjustment Credit, which was distributed to you today by the Region, will be discussed at an Operations Committee meeting on Wednesday, January 13 at 3 p.m. in Room E-1244. An agenda for the meeting will be issued shortly.

cc: Messrs. Hopper
Shakow
Holsen
Rao
Baneth
Thahane/Burmester
Lee
Steer
Baudon
Liebenthal
Fischer
Bock
Frank
Parmar
Hopper
Goldberg
Ms. Haug
SES:eg

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 11, 1988

TO: Operations Committee

FROM: E.G. Enzo Grilli, Acting Director, EAS

EXT.: 78061

SUBJECT: KENYA: Industrial Sector Adjustment Credit - Agenda

1. There will be a meeting of the Operations Committee on Wednesday, January 13, 1988, at 3:00 p.m. in Room E1244 to discuss the Initiating Memorandum (IM) dated January 5, 1988, on a proposed Industrial Sector Adjustment Credit (ISAC) to Kenya for US$107 million (US$77 million IDA and US$30 million SFA).

2. The IM discusses the country's economic performance and macro-economic management, describes the macro-economic and structural objectives and policies for 1988-90 and presents the measures proposed to be undertaken by the Government of Kenya as part of the industrial and trade sector adjustment programs intended to enhance the efficiency of the sector and improve the incentives and environment for investment and exports. This ISAC focuses on (i) rationalizing the import licensing mechanism, (ii) reforming the tariff system, (iii) readjusting price controls, (iv) improving the thrust and quantum of investment incentives, (v) restructuring and divesting some parastatals, and (vi) strengthening the financial sector. The proposed operation has been designed in the context of the revised country assistance strategy that recommends a marked shift away from the broadly based SALs and towards a disaggregated sector-based approach to adjustment.

3. The Committee may wish to discuss the following:

(a) Dispersion and Multiplicity of Objectives and Measures. As indicated in the IM's Policy Reform Matrix, the reform programs have eight major objectives and actions are sought in five principal areas/subsectors. There are 12 conditions for Board presentation such as tariff, prices and tax changes and 10 conditions for second tranche release including implementation of a comprehensive export-promotion program, action programs for DFIs and divestitute of PES. Further conditions will probably be added after appraisal particularly in regard to the difficult public enterprise subsector and in the restructuring of the development finance institutions for which work is expected to begin next month. The Bank's rather unhappy experience with SALs in Kenya was, among other things, due to the over-ambitious nature of those programs and extensiveness of conditions attached to them. Need this particular operation include not only industrial and trade sector policy issues but also the financial sector issues? Would it not be possible to leave out the financial sector (money, capital markets and DFIs) issues, particularly because a financial sector operation is also being prepared?

(b) Specific Reform Measures Sought Under the ISAC.

(i) Import Liberalization and Licensing. The proposed operation aims at reducing import schedules from four to three with some sub-categories in schedule III. If, as proposed, schedules I, II, and III-A are all to be made automatic, then it is not clear if all three schedules have in fact the same degree of automaticity or not and why is it necessary to compartmentalize them in different automatic categories? Can the process move towards one category of Open General Imports and another category of restricted imports, with varying degrees of restrictions, if necessary.

(ii) Tariff Reforms and Quantitative Restrictions (QRs). The ISAC's core policy agenda concentrates on tariff reforms with the objective of simplifying the tariff structure, rationalizing it, lowering the effective rates of protection and making them more even across the sector. Two immediate questions arise: How is the concentration of tariff reforms in raw materials, intermediate and capital goods imports likely to affect EPRs and is the proposed time schedule realistic to accomplish the process of tariff reforms? Also, it is not quite clear how extensive the quantitative restrictions are, what proportion of imports in relation to production are subject to QRs and how soon QRs can be dismantled? If QRs are large and binding, the reduction of tariff is not going to be very meaningful. These are aspects of the proposal that need clarification.

(iii) Kenya's manufactured exports are small (8% of manufacturing output and 16% of total exports) and performance has been disappointing. Looking ahead, manufactured exports are not projected to go beyond 22% of total exports by 1995--which is still well below what they were in 1965 (33%). Most of the country's current export of manufactured goods are subject to quota restrictions in importing countries and severe international competition. In these circumstances, will the proposed operation make a sufficiently encouraging contribution to enhanced export earnings to sustain the Government's interest and enthusiasm for the adjustment process?

(iv) One of the crucial problems faced by Kenya is employment of its burgeoning labor force. Is the manufacturing sector sufficiently labor-intensive and does it have a reasonable employment potential to meet the challenge? Generally the small and medium industries (SMIs) are more labor intensive than the large scale segment of the manufacturing sector. In the Region's judgement how effective the Government's plans and programs are for the promotion and assistance of SMIs?

(v) Given the country's rapid population increase and growth in it's labor force, the question of the social cost of the adjustment process seems to have been treated lightly in the IM. There will be some real transitional costs as a consequence of the proposed operation. The magnitude of corrections in pricing policies, industrial restructuring, etc. is not insignificant and the short term potential consequences are likely to be considerable. In practice it may be difficult to offset the contractionary effects of reduced activities with simultaneous expansionary effects in other activities as suggested in the IM, especially when the public sector is also not expected to provide any cushion. What specific devices the Government proposes to use to address the anticipated social costs of the program and it's possible adverse effects on certain groups?

(vi) As the IM argues it is important to decontrol prices. About 25 product groups from a list of about 40 would be decontrolled by end 1988. What would be the weight of the decontrolled items and how important would be the product groups remaining under price controls most of which are likely to be monopolies and "socially sensitive" items.

(vii) Investment Incentives. The IM proposes a number of policy actions in this area. They will take time to become important vehicles for investment promotion. Meanwhile the effects from the removal of disincentives can be expected to be significant. Therefore, what are the specific rules, regulations, procedures and mechanisms in the investment and trade areas that need immediate attention and what is being done or proposed to improve them?

(viii) Administrative and Institutional Capabilities. The IM correctly points out that institutional capabilities are limited (particularly in the Ministry of Industry), yet it is not clear how this important deficiency would be rectified within the context of

<u>the proposed operation</u>. In its present formulation, the Ministry of Finance and the Central Bank are the only core agencies involved in the adjustment operation. Could the Region elaborate in what sense "weak administrative capabilities in Kenya (which) could hamper preparation and implementation of the Program" are within manageable bounds?

cc: Messrs. D. Lee (CODDR), Shakow (SPRDR), Holsen (CECDR), D. C. Rao (FRSDR), Baneth (IECDR), Thahane/Burmester (SEC), R. Liebenthal (SPRPA), A. Steer (FRSDR), Baudon (SVPOP)

cc for information: Messrs. S. Fischer (VPDEC), Bock (DFADR), R. Frank (CFPVP), J. Parmar (CIOVP), D. Hopper (SVPPR), Ms. Haug (EXC), D. Goldberg (VPLEG), R. Agarwala (AFRVP), Wackman, Khanna/Horton (AF2IE)

FMChaudhri:cmc

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 11, 1988

TO: Operations Committee

FROM: EG Enzo Grilli, Acting Director, EAS

EXTENSION: 78061

SUBJECT: MALAWI - Industry and Trade Policy Adjustment Credit - Agenda

1. The Operations Committee will meet on Wednesday, January 13, 1988 at 4:00 p.m. in Room E-1244 to consider the initiating memorandum (IM) for a proposed credit to Malawi of $60 million.

Background

2. An appraisal mission plans to leave for Malawi shortly. The Industry and Trade Policy Adjustment Credit is a part of a large and much needed adjustment and stabilization program to restore growth and external balance to the Malawi economy. Policy actions contemplated under the credit range from the elimination of the discretionary allocation of foreign exchange, shifting taxes from external trade to domestic transactions, reform of the trade and industrial licensing system, to the reform of the financial sector.

3. The proposed credit follows three SALs, and successive stand-by operations initiated since 1981. Under these programs, many reforms were undertaken leading to price rationalization and liberalization, improvement of public sector resource mobilization and management, rationalization of some external sector policies and re-structuring the para-statal sector.

4. With these reforms Malawi managed to reduce its domestic and external imbalances and resume GDP growth in the 1982-85 period. However, in 1986, a combination of external factors and policy failures halted the path progress and partially reversed the gains of the 1982-85. Thus, in 1986 serious macroeconomic imbalances emerged and led to policies that have deleterious effects on resource allocation and growth. The fiscal deficit increased from 6% of GDP in 1985/1986 to 14% in 1987, credit to the private sector was crowded out, external debt arrears and capital outflows increased and informal controls on foreign exchange and trade became more stringent. There is thus the need for a broad based adjustment task that relates to the macroeconomic situation, the trade and foreign exchange regime and the industry and financial sectors.

The Suitability of a Sector Adjustment Operation

5. Given that the basic problems facing Malawian economy today are largely macroeconomic in nature, and effect all sectors, a wide ranging adjustment effort is needed to address the fiscal deficit, the financial

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sector crowding out, the over-valued exchange rate, capital outflows and debt arrears. Indeed the success of the proposed Industry and Trade Policy adjustment credit will hinge on the progress achieved in addressing the macroeconomic issues as identified in the IM.

- How does the Region propose to ensure that the economy wide medium term adjustment issues are adequately addressed?

- What are the government's intentions in addressing the macroeconomic issues? Could they be clearly spelt out in a Policy Framework paper agreed with the government before the details of this credit can be finalized?

Implementation Issues

6. The coordination of macroeconomic adjustments and sector related polices over a wide ranging domain could pose implementation difficulties. The IM states that the governments management and implementation capabilities to supervise a comprehensive macroeconomic and sector adjustment program have been stretched. (Paragraph 18). Nevertheless, the coordination and implementation of disaggregated sector adjustments with the many elements described in the IM, could also pose difficulties.

- Could the Region describe the measures contemplated to improve implementation and articulate priorities within the wide ranging policy changes attempted through the credit?

The Foreign Exchange Allocation System

7. According to the IM the government is committed to a liberalization of the foreign exchange allocation system. The IM proposes a phased system that begins with the liberalization of some raw materials and spare parts to be extended to other raw materials and spare parts and and finally to most intermediate goods and capital goods.

- How does the Region propose to handle the bias that could arise against non-industrial goods from the increased access to raw materials and spare parts to the industrial sector?

The Sequencing of the Reforms

8. The IM recognizes that the success of the Industrial and Trade Adjustment Credit depends on the proper sequencing of the overall adjustment program. Thus, a condition for Board presentation of the credit is an agreement with the IMF on the management of the exchange rate within the context of a stand-by program.

- Could the Region describe the sequencing of the liberalization polices within the trade regime in respect of exports, imports and the exchange rate and in relation to industrial licensing and financial reforms?

Distribution

cc: Messrs. Lee (CODDR); Shakow (SPRDR); Holsen (CECDR); Rao (FRSDR); Baneth (IECDR); Thahane (SEC); Burmester (SEC); Liebenthal (SPRPA); Steer (FRSDR) and Baudon

FOR INFORMATION ONLY: Sandstrom (AF6DR); Belli (AF6IE); Cook (AF6IE); Fischer (VPDEC); Bock (DFSDR); Frank (CFPVP); Parmar (CIOVP); Hopper (SVPPR); Ms. Haug (EXC); Goldberg (VPLEG) and Agarwala (AFRVP)

SR/mb

December 10, 1987

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 7, 1987

TO: Operations Committee

FROM: ~~Vinod~~ V. Dubey Dubey, Director, EAS

EXT: 78051

SUBJECT: Adjustment Lending Progress Report - Change in Time of Meeting

The Operations Committee will meet at 2:30 p.m. on Thursday, December 10 in Room E-1244 to discuss the Adjustment Lending Progress Report. An Agenda will be issued shortly by the Strategic Planning and Review Department.

cc: Messrs. Lee, Dubey, Shakow, Holsen, Rao, Baneth, Thahane/Burmester, Liebenthal, Steer, Baudon

cc for information: Messrs. Fischer, Bock, Frank, Parmar, Hopper, Goldberg, Agarwala, and Ms. Haug

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 7, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXT: 78051

SUBJECT: Mexico: Agricultural Sector Adjustment Loan
Agricultural Technical Assistance Loan
Fertilizer Sector Adjustment Loan

The Operations Committee will meet at 4:00 p.m. on Thursday, December 10 in Room E-1244. The covering memoranda by the Region which were circulated with the documents will provide the basis for the discussion.

cc: Messrs. Lee, Shakow, Holsen, Rao, Baneth, Thahane/Burmester, Liebenthal, Steer, Baudon, Binswanger, Knotter

cc for information: Messrs. Fischer, Bock, Frank, Parmar, Hopper, Goldberg and Ms. Haug

December 10, 1987

Mr. Qureshi

Moeen:

Re: Progress Report on Adjustment Lending

Enzo has prepared a very comprehensive note for you (attached) on this report and, further to our conversation this morning, I have listed below in bullet form only a few key specific points that may be useful for the discussion. You should first bear in mind that this is the third report on adjustment lending we are sending to the Board; consequently, expectations are high, which makes the shallowness of the report even less acceptable. It puts you in the difficult position to decide whether to let it go or not, knowing that there is no "quick-fix" solution (a high-quality product will take time to prepare).

The report is particularly inadequate in its treatment of the following key concerns:

a) impact assessment of adjustment lending

b) design flaws and lessons from experience

Impact Assessment

- the methodology of impact assessment is neither explained nor reviewed in its application. In a number of our policy-based operations (SALs and sector loans), a fairly comprehensive methodology has been developed to assess the impact of the policy reform packages on macro-variables (BOP, fiscal side, ...) as well as on the supply response (aggregate growth, sectoral composition of output, etc...) and on "social" aspects (income distribution effects, low-income groups, etc...). At the same time, in the absence of an accepted institution-wide framework for such analysis, each Region, Department and Division has developed its own way of carrying out this impact analysis. The report could have:

    - explained the various analytical frameworks used for the impact assessments across the Bank and carried out a comparative review;

    - assessed to what extent this analytical framework is sufficiently robust to be used for an ex-post review of the key causes of deviation in the adjustment process;

    - given an account of how the use of this methodology during implementation helped in correcting design flaws at later stages of the adjustment process.

Design Flaws and Lessons from Experience

The design aspects are not covered in any sensible way, nor are any lessons drawn brought to the attention of the reader. A lot more could have been said on the following mistakes the Bank made in the early years (and still makes in some cases):

- lack of attention to the set of conditions necessary to generate a supply response in the economy; we have often focused exclusively on the price system (which is necessary but not sufficient) and ignored fundamental structural/institutional aspects; this could have been documented properly in the report;

- the lack of precision in the mix and sequencing of trade liberalization and public finance components of adjustment programs; we have come close to disaster in a number of places by having the wrong mix in the wrong sequence!

- excessive emphasis on export promotion without fully exploring the trade-offs (particularly in highly indebted countries).

Footnotes

Little is being said on experience in implementation (particularly the political economy aspects of implementation and its consequences on how the Bank should adjust to changing conditions in a country), while poor implementation is probably the single largest cause for failure in the aggregate (ahead of design problems).

On balance, even if it will require some explanation to the Board, I would recommend that you don't let this paper go.

Thierry

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Baudon

DATE: December 8, 1987

TO: Mr. Moeen A. Qureshi, SVPOP

FROM: Enzo Grilli EG and Salah El Serafy, EAS SES

EXT: 78061 and 78072

SUBJECT: Progress Report on Adjustment Lending

1. The Operations Committee will meet on December 10 at 2:30 p.m. in Room E 1244 to discuss the draft Progress Report on Adjustment Lending which has been prepared by PPR. PPR has just circulated an agenda for that meeting, raising the following issues:

(a) the report is mainly silent on substantive issues (e.g. what such lending has accomplished; are the conditions well formulated and not too harsh or too lenient) and the OC is requested to provide guidance on how to handle the gap between the report and Board expectations;

(b) at the October 13, 1987 Board meeting, the President had said that this progress report would address the "appropriate share of adjustment lending in total lending". The present draft merely states that this would remain at a quarter of Bank lending for the foreseeable future. Should the report say more on this issue?;

(c) the report says that supervision of adjustment loans has been inadequate, with emphasis placed on processing future operations, and promises that better attention will be paid to design in order to improve implementation. These undertakings are not, however, made explicit in their technical or operational implications. The report also promises increased use of performance indicators to measure program "outputs". The OC is being asked if it would endorse such policy statements.

(d) lastly, the OC is asked if it considers the report's analysis of impact adequate, with reference to five country cases.

2. You will note that only item (c) above raises policy issues, whereas the other questions are essentially requests for OC's reactions to or endorsements of largely descriptive statements.

3. Aside from the agenda, we wish to make the following observations on the subject matter of the report which is obviously difficult. In fairness, PPR appears to have striven to deal with the issues you raised in your memorandum of July 16, 1987 to Mr. Hopper. It is clear, however, that the report lacks depth, that it is derivative in several parts, and its

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message is not very clear. You may judge that putting the report in this form to the Board may not be in the best interest of the image of the new Bank. The possible costs of delaying the report beyond the January 1988 promised date are that: (a) Board expectations might be raised, where considerable effort and time would be necessary before the substance of the paper can be improved significantly or; (b) the Board may take the delay as a sign of management uneasiness over a key set of Bank operations. Neither alternative can be easily judged in cost/benefit terms. What follows is a brief review of the main parts of the paper, and more precise indications of the points of the draft on which particular attention should be focused.

4. Part II of the paper illustrates the main trends in adjustment lending. A key issue here is why the growth of sector adjustment lending has been much faster than that of general structural adjustment lending. This trend is attributed in the paper to the "broadening and deepening of the adjustment process." Yet, though not shown explicitly, sector loans have often been made without being preceded by structural adjustment loans, and have prevailed in low income countries as well, where the claim that the adjustment process is deepening may sound rather hollow. The high incidence of sector loans in our portfolio of adjustment operations may well reflect supply as much as demand factors. Among the supply factors is our less than completely elastic capacity to offer assistance for broad structural adjustment lending. This in fact is recognized later on in the paper, where it is admitted that the Bank does not have a comprehensive analytical framework for designing (or evaluating _ex-post_) the results of its adjustment lending (p. 26).

5. In Part III of the paper the importance of an appropriate framework for adjustment lending is underlined. This section is fine, even if it draws a rather schematic distinction between the macroeconomic and the policy framework of adjustment lending. Clearly these are two moments of the same (continuous) process.

6. Part IV deals with the core issue of the macroeconomic impact of our adjustment lending. It makes the point that evaluating this impact is very difficult, because everything changes, and the _ceteris paribus_ assumption needed to evaluate the impact does not hold. Yet the point is still made in the paper that of the 16 countries that undertook structural adjustment (surveyed in Annex 3), 11 had higher GDP growth than a non-specified "comparator group". This whole quantitative section is spurious and quite confusing. It raises more questions that it answers. In addition the review of the specific experience of 5 adjusting countries (Turkey, Cote d'Ivoire, Chile, Ghana and Jamaica) is rather shallow. A good idea--the review of country experience--seems in fact to have been turned into a bad one. Clearly this aspect of adjustment should receive attention in future work programs for PPR, and the Board may be told that a more detailed consideration of impact, drawing in part on OED work would be forthcoming at a future date.

7. In Part V the paper makes an effort to deal with the institutional and poverty impact of adjustment programs, based on the analysis and conclusions of several Bank and non-Bank papers on the subject. By and large the draft paper succeeds in painting an acceptably

balanced picture of targets and instruments available to reach them. This section is fine.

8. Part VI is probably the most puzzling one of the whole paper. It is termed "overview" and yet it deals with 4 issues: conditionality, design, social issues and impact, the first two of which belong to Part III and the second two belong to Part IV and V respectively. This is clearly a part which has been added to the paper as an afterthought, with the aim of satisfying some of the specific requests made in your memorandum of July 16 (points iii, iv and v). But the whole section is disjointed and superficial. The treatment of conditionality refers heavily to the finding of the 1986 Joint Audit Committee's report on Project Performance. It talks in a rather summary fashion of the need for careful monitoring and of the use of detailed performance indicators, and ends with a pledge to use them (see para. 1 (c) above). The sub-section on design is practically non-existent. It draws from a 1986 (ERS) paper prepared for a Joint Bank/Fund seminar in which are highlighted in a rather lopsided fashion the major "focuses" of Bank adjustment programs. The results are predictable. The sub-section says little if anything about the elements of design of adjustment programs where we have been successful or have confronted particular problems. You may decide that this part should be re-written.

9. Finally, Part VI ends with the statement (made also in the beginning) that future (Bank) adjustment lending is expected to remain at 25% of total lending. This matter deserves attention, as nowhere in the paper is the case made to establish why this ratio should be at that level (see also para. 1 (b) above).

10. We would be glad to discuss the paper with you (and what may possibly be done with it) before the OC meeting, if you think it useful.

cc: Messrs. Vergin, Dubey, Baudon

EGrilli/SESerafy:df

Mr. Qureshi

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 7, 1987

TO: Operations Committee

FROM: Alexander Shakow, Director, SPR

EXTENSION: 34697

SUBJECT: Adjustment Lending Progress Report - Agenda

Attached is an agenda of issues identified by SPR for consideration by the Committee. The suggested agenda items are:

(a) Share of Adjustment Lending in Total Lending
(b) Trends in Type of Adjustment Loan
(c) Importance of Supervision
(d) Use of Performance Indicators
(e) Analysis of Economic Impact of Adjustment Programs
(f) Scope of the Report

The Operations Committee will meet on Thursday, December 10 at 2:30 in Room E-1244. **Please note that the meeting is now at 2:30 and not at 3:00 as originally scheduled**.

Attachment

cc: Messrs: Hopper (o/r), Liebenthal, Lee, Dubey, Holsen, Rao, Baneth, Burmester, Steer, Fischer, Bock, Frank, Parmer, Goldberg, Baudon.

Ms. Haug

PNicholas/pn

ADJUSTMENT LENDING PROGRESS REPORT

Topics for Discussion

Share of Adjustment Lending in Total Lending

1. Mr. Conable promised, at the October 13 Board meeting, that the Progress Report would address the issue of what would be an "appropriate" share for adjustment lending in total lending. The current draft of the Progress Report merely notes (paragraph xvii on page viii) that adjustment lending is expected to be about 25 percent of the total for the next several years. What further should be said?

Trends in Type of Adjustment Loan

2. The concluding remarks state (paragraph xvii on page viii): "Within adjustment lending, current projections suggest that the volume of sector operations is likely to increase as adjustment is deepened and broadened in countries where macroeconomic stabilization and restructuring programs are well underway. Within sector adjustment lending there will probably be a shift away from trade loans and towards more support for the elements of domestic supply response such as taxation, investment efficiency and financial and investment restructuring. This shift is likely to produce an increase in the use of "hybrid" loans, and in the design of lending programs employing a sequence of such loans". Does the Operations Committee agree that this represents future trends?

Importance of Supervision

3. The current draft (paragraph xii on page v) commits the Bank to a policy change as follows: "The Bank will therefore give higher priority to supervision, and pay more attention in the design of adjustment programs to the details of implementation arrangements." This commitment is based on OED findings. Does the Operations Committee endorse it?

Use of Performance Indicators

4. The same paragraph also commits the Bank to make more use of detailed performance indicators. These would measure the "output" of adjustment programs by tracking, for example, the level of tax collection or the ratio of teachers to students (see further paragraphs 97-98 on pages 58-59). Does the Operations Committee endorse the increased use of such indicators?

Analysis of Economic Impact of Adjustment Programs

5. The Board is keen to see an analysis of the economic impact of adjustment programs. The report therefore provides (paragraph xiii on pages v-vi and Section IV) some indicative statistics correlating

adjustment programs with growth rates, along with brief commentaries on five country experiences. This analysis would not, as the report acknowledges, stand up to much careful scrutiny. The comparison of growth rates for adjusting countries with growth rates for comparator countries does not attempt to factor in differences in exogenous conditions. Does the Operations Committee feel that the analysis is sufficiently useful to be included in the Board version?

Scope of the Report

6. As this is a Progress Report and not a major evaluation of adjustment lending, the report says less about certain substantive issues than the Board -- and we -- would like: What has adjustment lending accomplished? How well tailored to individual country needs has it been? Has conditionality been too harsh or too lenient? PPR work programs (see paragraph iv) will explore these and other issues, but does the Operations Committee have guidance on how to handle the gap between Board expectations and the actual content of the report?

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 8, 1987

TO: Mr. Moeen A. Qureshi, SVPOP

THROUGH: Vinod Dubey, Director, EAS V.Dubey

FROM: Anandarup Ray, EAS

EXT: 78073

SUBJECT: Mexico Loans: OC Meeting on Thursday, December 10, 1987

1. Here are some notes on the changes since the IM stage, with reference to the Region's cover memoranda:

Fertilizers

2. Almost all the issues in Mr. Knotter's memo are minor. Thus:

- the concept of a mid-term review in March 1989 to replace tranching (para. 4) was approved by the Loan Committee,

- the coordination of fertilizer and agricultural product prices is not an issue, as explained in Mr. Knotter's para. 5. Besides the issue was always overdone. Fertilizers are a small fraction of cost at the margin of farming. A 1% change in output price has much larger leverage than changes in the fertilizer price.

- Ammonia pricing. The changes since the IM are an improvement. The remaining ammonia subsidy will now be less,

- Plant closure program. The downsizing of the program is satisfactorily explained in Mr. Knotter's para. 7.

- This leaves Retail Distribution as an issue. Originally, Fertimex was to withdraw from retailing within 3 years; no studies were envisaged. Now, (i) a study will be done in the first half of 1988 to define a plan of action; (ii) complete withdrawal must take place no later than 5 years, and (iii) by mid-term review, at least 10% of total sales will be transferred to private sector.

- The Reorganization Study; this has been delayed by six months.

Agricultural Sector Adjustment Loan

3. With reference to Mr. Binswanger's note:

- Price guarantee system and commodity coverage. There are 13 products that are covered by price guarantee systems. Originally, these were split into two groups: (a) 6 basic products; changes for these were to be studied, (b) the 7 other minor products for which the guarantee system were to be given up. Now, there is no change for the basic products. However, the minor products are also to be studied, action being deferred. While this is a dilution, the minor products account for only some 0.27% of GDP, or about 3.4% of agricultural GDP.

- Milk import monopoly. Originally, CONASUPO was to give this up. But this would not have been import liberalization. Some private firms would have imported milk subject to quotas instead. Now, CONASUPO is to keep the monopoly. The Region feels that it would be difficult to transfer the monopoly since CONASUPO uses the profits to fund subsidized milk programs for poor families. It would take time to work out alternative arrangements.

- Consumer price decontrols. The idea of reducing products under strict control from 21 to 3 is likely to be resisted by the Mexicans. Hence, the Region's plea for flexibility. We should insist on decontrolling at least the important potentially exportable products, like beef.

ARay:df

Nov. 16, 1987

Mr Qureshi

The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee to Consider
COTE d'IVOIRE - Initiating Memoranda for an Agricultural Sector Adjustment Loan and an Energy Sector Adjustment Loan

Held on Monday, November 16, 1987 in Conference Room E-1208

A. Present

Committee

Messrs: M. Qureshi (Chairman)
E. Jaycox (AFRVP)
S. Husain (LACVP)
I. Shihata (LEGVP)
J. Wood (VPFPR)
A. Karaosmanoglu (ASIVP)
P. Hasan (EMNVP)
R. Liebenthal (SVPPR)

Others

Messrs: I. Serageldin (AF1DR)
D. Singh (AF1DR)
A. Benbrahim (AF1CO)
K. Cleaver (AF1AG)
M. Wormser (AF1IE)
M. Wilton (AF1IE)
J. Bond (AF1IE)
M. Cherif (AF1CO)
H. Ghanem (AF1CO)
D. Rao (FRS)
F. Earwaker (SPRPA)
T. Baudon (SVPOP)
V. Dubey (EAS)
U. Thumm (EAS)
A. Rigo (LEGAF)
A. Hovaguimian (CA1DR)
P. Lietard (CA1DI)
R. Harris (CODOP)
R. Carstens (IMF)
A. Toft (DFS)
Ms. C. Morin (LEGAF)

B. Issues

1. The meeting was called on the IMs for a proposed $150 million Agricultural Sector Adjustment Loan (ASAL) and a $100 million Energy Sector Adjustment Loan (ESAL) to Cote d'Ivoire. The discussion mostly followed the agenda prepared by the Economic Advisory Staff, with heavy emphasis on country issues. The issues raised were (a) country creditworthiness and Bank assistance strategy, (b) specific ASAL related issues, viz. (i) the appropriateness of the proposed conditionality for the ASAL, (ii) the proposed disbursement mechanism for the ASAL and (c) the design of and proposed conditionality for the ESAL.

C. The Discussion

Country Creditworthiness and Bank Assistance Strategy

2. The Chairman started the meeting by asking the Region to comment on the justification of the Bank's role, the corresponding implication for Bank exposure and burden sharing with other creditors, and the realism of the underlying fiscal and balance of payments projections in light of past experience. The Region responded by describing the economic situation in 1986 as the result of relatively successful stabilization and adjustment efforts which led to a resumption of economic growth and was the basis for the MYRA with the London and Paris Clubs. The Region then went on to explain that conditions outside the government's control deteriorated in 1986-87 with the sharp drop in the country's terms of trade and the appreciation of the CFA franc vis-a-vis the dollar, that the situation was aggravated by substantial outflows of private capital, and that the government had to declare a debt moratorium in May 1987. It was stressed that--in spite of major efforts to diversify the economy--the country was still hostage to the development of a small number of commodities and that a contingency facility had not been conceded as part of the 1986 MYRA. What was needed now was an innovative solution, preferably without increase in the existing stock of debt and with equitable burden sharing between the country (through additional adjustment efforts) and its creditors (through debt relief and fresh money). The Region pointed out that the government adopted new measures in August (which fell somewhat short of expectations) and proposed a comprehensive refinancing plan which was reflected in the "high debt relief scenario".

3. Several speakers expressed doubts as to the feasibility of the "high debt relief scenario" and the justification for corresponding Bank support through substantial frontloading of Bank assistance, particularly given the relatively modest results of adjustment to date in terms of domestic savings and efficiency gains, the persistent fiscal weaknesses, and the high risks entailed in the country's continued vulnerability to external shocks. It was stressed that improved fiscal performance was crucial to the restoration of creditworthiness, and it was questioned whether bringing forward a SAL IV might not be a better way of providing support for broadly based structural change rather than the proposed ASAL and ESAL. The Region, while recognizing the risks of external shocks, pointed out that the increase in Bank exposure would be carefully managed with a view to actions by other creditors and through the specific design and tranching of the proposed fast-disbursing operations. The Region also emphasized that both the ASAL and ESAL were central to address key concerns regarding the country's fiscal performance and the strengthening and diversification of its economic structure to improve the country's creditworthiness.

4. Additional doubts were expressed regarding the viability of the adjustment program in the absence of an adequate supply response from the private sector. The IFC representative mentioned a number of serious impediments to increased private sector investment. While there was agreement that the exchange rate was also an important factor affecting economic performance, the IMF representative stated that the issue had not been discussed during his recent mission to Cote d'Ivoire and that he did not anticipate any IMF initiative in this regard at a higher level.

5. The Chairman concluded the discussion on the first set of issues by saying that, given Ivory Coast's heavy indebtedness and weak creditworthiness, the Bank could envisage a substantial increase in its exposure only if there was a comparable response by other creditors, e.g., through a generous debt-restructuring within the London and Paris Clubs. The Bank's resources are designed to support the country's development efforts and therefore must be conditioned on an appropriate burden-sharing response by other creditors. The Region was also asked to reassess the appropriateness of the blend between quick-disbursing and traditional project loans.

ASAL Related Issues

6. Appropriateness of proposed conditionality. Concern was expressed that the proposed ASAL (and previous adjustment operations for that matter) did not adequately address the issue of the proliferation of government involvement in agriculture. The specific question was raised whether the Bank should not demand the dismantling of all government marketing monopolies. The Region responded by first referring to the good agricultural performance record of the past and pointed out that some progress had been made with privatization of marketing of cereals. While the ASAL would support some further expansion of the liberalization process, an acceleration of the process was currently neither necessarily desirable nor feasible given the relative efficiency of parastatals, poor prospects of profitability, and the lead time required for effective transfer of responsibilities to the private sector.

7. The question was also raised whether more forceful action was not required to improve the fiscal situation by accelerating the implementation of the proposed tax measures and possibly cutting subsidies. The Region pointed out that the preparation of tax measures required additional time and would not be ready for Board presentation in February. The Region also mentioned that the government intended to improve resource mobilization as fast as possible. On the other hand, the Region maintained that export subsidies were important and barely sufficient to compensate for the exchange rate overvaluation. It was added that a change in the composition of public investment in favor of rural areas was needed to supplement the export subsidies, hence the proposed conditions regarding rural infrastructure and social services.

8. The Chairman concluded the discussion on this topic by asking the Region to review carefully the proposed loan conditionality and its timing, with the burden of proof on the Region.

9. Proposed disbursement mechanism. The question was raised whether linking loan disbursements to domestic expenditures and earmarking of $15 million of loan proceeds for TA type expenditures was justified and would not complicate things or even create an incentive to spend without real justification. The Region maintained that strong assurances were needed to provide for the shift in government spending in favor of rural areas and that the most effective way was linking loan disbursement to actual government performance.

10. The Chairman approved the link of disbursements of the second and third tranches in the amount of $90 million to actual domestic expenditures as proposed. However, he decided to single out the $15 million component as a separate operation.

Design and Conditionality of ESAL

11. Concern was expressed that the proposed design and conditionality of the ESAL was not commensurate with the proposed disbursement profile. The Region agreed to explore the feasibility of a hybrid operation and of the acceleration of certain conditions. The Chairman decided that an OC meeting on the ESAL would be convened at the Green Cover stage.

C. Decisions

12. Subject to the specific modifications and decisions reflected in paras. 5, 8, 10 and 11, the Chairman authorized the Region to go ahead with the proposed operations.

UThumm:vlw
November 18, 1987

Mr Qureshi

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Projections - optimistic - Expenditure

DATE: November 11, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS
V. Dubey

EXT: 78051

SUBJECT: COTE D'IVOIRE - Proposed US$150 Million Agricultural Sector Adjustment Loan; US$100 Million Energy Sector Adjustment Loan, Initiating Memoranda - Agenda

1. The Operations Committee will meet on Monday, November 16, 1987 at 4:00 p.m. in Room E-1208 to discuss the Initiating Memoranda for a proposed $150 million Agricultural Sector Adjustment Loan (ASAL) and a proposed $100 million Energy Sector Adjustment Loan (ESAL) to Cote d'Ivoire. The Operations Committee may wish to discuss the issues raised in paras. 4 to 11 below.

Background

2. The proposed ASAL and ESAL would consolidate policy reforms in macroeconomic and public sector management initiated under previous SALs, deepen reform action with regard to the agriculture and energy sectors, and improve resource mobilization and resource use, particularly by directing public expenditures towards the rural population. The proposed ASAL and ESAL, together with other adjustment operations, constitute important elements in the Region's proposed country assistance strategy and the Cote d'Ivoire's tentative external financing program for 1988-92, which was discussed in the attachment to Mr. Poortman's October 21, 1987 memorandum to Mr. Qureshi "Cote d'Ivoire - Revised Update of Economic Situation and Bank Strategy." Given the proposed loans' broader importance and the implications for Bank exposure it may be appropriate to discuss some issues related to the proposed assistance strategy, in addition to those strictly related to the ASAL and ESAL.

Country Assistance Strategy

3. The Region proposes a $1380 million lending program for FY88-92, with about 40 percent allocated to quick-disbursing, policy-based loans. This would be a major contribution to cover Cote d'Ivoire's 1988-92 external financing needs. Under the preferred scenario (high debt relief), the Bank would contribute about two-thirds to the projected net capital flow, bilaterals over 120 percent, while private sources' exposure would be substantially reduced. As a result, Bank exposure would increase from a projected 18 percent of total DOD at the end of 1987 to about 24 percent in 1992 and over 25 percent in 1995. The proposed workout plan is obviously predicated on good economic performance as a result of continued vigorous adjustment and no further deterioration of the international environment. However, the case for the preferred scenario does not appear as strong as the text suggests. Contrary to the statement in para. 30 regarding the

"marked deterioration in the creditworthiness indicators" with conventional rescheduling, the table on page 3 of attachment IV shows an improvement. Under the circumstances, the net costs and benefits of the preferred scenario as the approach to be pursued to recover creditworthiness over the medium term need to be better established.

4. Several additional questions arise in this context:

(a) Regarding the government's commitment to the adjustment process, could the Region give a brief progress report on SAL III, elaborate on the areas of "resistance" mentioned in para. 7 of the attachment to Mr. Poortman's memorandum, and give a brief overall assessment of the adjustment process to date?

(b) Given the (realistic) assessment of the external environment (para. 20), the balance of payments and growth projections seem to be somewhat optimistic. The assumed efficiency gains for investment--ICOR going down to about 3 as compared to over 4 in the second half of the 1970s and over 7 at the beginning of the 1980s--also appears optimistic. Finally, the assumed reduction in public spending relative to GDP may be difficult to achieve thus shedding additional doubt on the feasibility of the financing plan. Could the Region comment on the implications of less favorable performance for (i) the proposed debt workout and (ii) the thrust and timing of the proposed adjustment program? In this context, the question may also be raised, whether--in the absence of exchange rate flexibility-- a viable adjustment program would have to be more restrictive and impede any resumption of growth.

(c) The preferred scenario with its exit bonds implies some loss on the side of commercial banks (equivalent to about 5 percent of their current portfolio at the current LIBOR of about 7-1/2%), but allows them to reduce their exposure substantially. The question arises whether a more traditional workout (e.g. scenario III) with more equal burden sharing and lower Bank exposure would not be preferable from the Bank's point of view. This would also have implications for the size of the proposed lending program.

Specific ASAL Issues

5. Pricing Policy and Taxation. A major thrust of the ongoing adjustment process has been the adjustment of producer prices for Cote d'Ivoire's main export commodities towards world market levels, with immediate repercussions for government revenues. It is proposed to continue price adjustments (with some correction of relative prices between coffee and cocoa) while at the same time introducing floor prices and to expand non-export taxation. Price adjustments are also proposed for some other commodities. Several questions could be raised:

(a) Could the Region explain why it does not pursue the first best solution, i.e., the dismantling of the government monopoly and the introduction of a progressive windfall tax on all traditional export commodities to be applied above a certain price threshold to facilitate fiscal and monetary management?

(b) In the absence of the first best, why would we want to support the introduction of floor prices which may become fiscally unmanageable? And could action related to CSSPPA's operation not be advanced to a date earlier than the third tranche?

(c) Given the extent of earlier price adjustments and their fiscal impact, as well as the risks entailed in the financial projections, could some of the proposed tax measures (i.e. expansion of VAT coverage; better collection of real estate taxes; preparatory steps towards land taxation) not be accelerated?

(d) In the same broad context, could the liberalization of rice and wheat flour marketing and the parallel reduction in subsidies not be accelerated? Similarly, could the liberalization of marketing arrangements for palm oil and cotton be sped up?

6. Government Expenditures. Prudent government spending is recognized as being crucial for the country's overall economic viability, and major reductions are anticipated in relation to GDP (possibly erring on the optimistic side). Given the Bank's long-standing involvement in the adjustment process, should we not have a prior agreement (condition of Board presentation) on a multi-year expenditure program to be updated on a rolling basis rather than the proposed agreements on annual programs as second and third tranche conditions?

7. BNDA. Financial restructuring and institutional strengthening of BNDA are proposed to improve agricultural sector financing. Does the Region propose to make the various measures for institutional strengthening mentioned in para. 18 formal tranche conditions?

8. Rural Infrastructure and Social Services. Master Plans are proposed for rural health and education and annual reviews of the infrastructure program as part of overall expenditure reviews. The question arises whether this does not dilute the policy focus of the proposed ASAL and make it difficult to monitor and whether these particular aspects could not be adequately covered under the overall agreement on government spending.

9. Disbursements. The Region proposes to disburse $135 million in three tranches; the first $45 million would be disbursed against general imports, without linkage to domestic expenditures, while disbursement of the other two tranches would be also against imports but depending on actual government expenditure items. The remaining $15 million would be disbursed against expenditures related to specific actions under the adjustment program (para. 39). The question arises why, in addition to an agreement on government expenditures, Bank loan disbursements would have to be earmarked and whether the design of the $15 million portion would not slow down disbursements and a separate TA type loan would not be preferable?

Specific ESAL Issues

10. Specificity of Sector Adjustment Program. As in the case of the ASAL, the ESAL would support the extension of the adjustment process to the sector level and, more specifically, follow up on actions initiated under SAL. However, while the IM describes the sector's institutional and financial problems in broad terms, it lacks specificity, e.g., data on the sector's current financial situation and projections reflecting specific actions are not shown. Financial projections would be needed to give the adjustment program a specific sense of direction that is monitorable. The Committee may wish to ask the Region to provide this information at the green cover stage. Moreover, the Committee could ask the Region to include specific financial targets as loan conditions or alternatively have the execution and implementation of performance contracts, both satisfactory to the Bank included as formal conditions.

11. Timing of Sector Adjustment Program. While some action was to be initiated under SAL III and would be expected to be completed before the appraisal of the ESAL and some additional measures would be in place before Board presentation, many important measures (e.g., adoption of performance contracts; revised electricity law; revised EECI statutes; definition of rural electrification policy; implementation of revised power tariffs) are proposed only as conditions for the release of the second tranche. Given the severity of the sector's financial problems, the Committee may wish to ask the Region to advance those measures that have a critical bearing on the sector's financial situation to Board presentation. P.18

12. Justification of Quick Disbursements. The proposed ESAL forms part of Cote d'Ivoire's broader medium-term financing plan. At the same time, it is the keystone in the energy sector's financial restructuring plan which also depends on extensive cofinancing from other agencies. While these features, if supported by a specific financing plan, could justify a fast-disbursing loan, there are a number of important time-consuming technical and institutional measures (e.g., those listed in para. 3.06 (i) b) of the IM) that would be better suited for support under a traditional investment project. The Committee may wish to explore the feasibility of a hybrid loan to better suit the sector's institutional needs.

cc: Messrs. Lee, COD: Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Baneth, IEC; Thahane/Burmester, SEC; Baudon, SVPOP; O'Brien, Serageldin, Landell-Mills, Cleaver, AFR.

cc: for information: Messrs. Fischer, VPDEC; Bock, DFA; Frank, Parmar, IFC; Goldberg, VPL; (Ms.) Haug, EXC.

WS
UThumm:df:vlw

Nov. 10, 1987

mr Qureshi

The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee Meeting to Consider
SRI LANKA - Policy Framework Paper

Held on November 10, 1987

A. Present

Committee

Messrs. M. Qureshi (Chairman)
A. Karaosmanoglu (AS1VP)
V. Rajagopalan (VPPRE)
I. Shihata (VPLEG)
W. Thalwitz (EMNVP)
J. Wood (VPFPR)
R. Steckhan (LAC)

Others

Messrs./Mmes. H. Aggarwal (AS1CO)
T. Baudon (SVPOP)
A. Clift (AS1CO)
V. Dubey (EAS)
R. Harris (CODOP)
A. McGuirk (IMF)
C. Obidegwu (SPRPA)
O. Rahkonen (SECGE)
A. Ray (EAS)
B. Sheahan (IFC)
A. Singh (IMF)
M. Wiehen (AS1)
O. Yenal (AS1VP)
R. Zagha (AS1CO)

B. Issues

1. The Committee considered the Policy Framework Paper (PFP) for Sri Lanka that was drafted in advance of Bank and Fund missions to discuss with the Government its policy program for the period 1988-90. The PFP would pave the way for an IMF Structural Adjustment Facility operation. The discussion focused first on the political uncertainties in Sri Lanka. Thereafter the discussion followed the agenda prepared by the EAS, which covered issues relating to program risks, public sector finances, trade and exchange rate policies, and sectoral policy conditionalities.

C. The Discussion

2. The Region explained that the Government is firmly committed to the basic policy framework described in the PFP. The proposed reforms focused mainly on the control of the public deficit and on the trade and export incentive framework. An important element was the reform of public enterprises through divestiture and improvements in efficiency. It was noted that the political situation remained very fragile; it is unclear whether an enduring cessation of hostilities can be achieved given that the implementation of the Peace Accord is being met with considerable

resistance. One can at best be cautiously optimistic at this point. A strong economic recovery, led by foreign investments, tourism and non-traditional exports, should result from a return to normalcy. The Bank plans to support the Government's efforts through the convening of the Special Aid Group scheduled for December 4, and subsequently through the proposed reconstruction credit.

3. The discussion then turned to specific aspects of the policy framework: (i) the realism of the base scenario; (ii) options available to reduce the public sector deficit; and (iii) the benchmarks that will guide changes in the exchange rate.

4. Base Scenario. The Region indicated that the assumptions underlying the base scenario were perhaps on the optimistic side but still realistic. On exports, the base scenario assumed a quick return to tourism to levels before the war, and the high real rate of growth assumed for non-traditional exports was still below what was achieved in the early 1980s. The constant level of imports, in real terms, was expected as a result of a decline in imports of military equipment and the continuation of the Government's policy of replacing food imports by domestic production. These two factors opened room for other imports to grow in line with the GDP, while keeping total imports constant in real terms.

5. The Reduction in Public Expenditures. The Region noted that the Government had already achieved a substantial reduction in the fiscal deficit from around 18% in the early 1980s to about 11-12% currently. The further planned reduction to about 9% of GDP by 1990 is attainable if peaceful conditions return to the country. Revenue generation at 20% of GDP was satisfactory. Further reduction in the deficit would be brought about by cuts in low priority expenditure. The Region indicated that one of the main objectives of a forthcoming economic mission would be to identify such cuts. In addition to planned cuts in defense expenditures, several areas offered potential for reduction, including Air Lanka, the fertilizer subsidy and investments in the Mahaweli program. In response to a speaker, the Region agreed that cost recovery in irrigation schemes was a major problem needing further attention. An Irrigation Strategy Review, planned for early next calendar year, would analyze this problem; its recommendations would be discussed with the Government with a view to implementing them during the adjustment period.

6. The Exchange Rate. The IMF representative explained that since 1985 the exchange rate policy pursued by the Government had led to an effective depreciation in Sri Lanka's real exchange rate vis-a-vis both the country's trading partners and the country's competitors. The country's export competitiveness has now been restored to the level prevailing in the early 1980s, before the rupee began appreciating. The Government has now agreed to maintain a flexible exchange rate with a view to keeping export competitiveness at least at the current level and to achieving quarterly net foreign exchange reserves targets to be set under the adjustment program. Such targeting is a usual feature of standby programs but unusual for SAFs.

7. In addition to these issues, a speaker noted that two projects (Dairy II and Mahaweli IV) contained IBRD financing and were not yet effective. The question was raised as to whether an effort should not been made by the Region to cancel these loans. The Region indicated that in the case of the Dairy II, entirely funded by IBRD, there was an indication that the Government may cancel the project by the end of the year and the Region had been informally encouraging the Government to take such a decision. As far as Mahaweli IV was concerned, the Government had been notified that the effectiveness date for the loan/credit would not be further extended.

Decision

8. The Chairman indicated that the next version of the PFP should: (i) include a few paragraphs on the Government's public expenditure program and comment on the country's rehabilitation needs; (ii) be more specific on IDA's sectoral strategies indicating where sufficient sectoral knowledge exists; and (iii) indicate the role and future plans of the IMF and the Bank in the section on external assistance requirements, highlighting the role of the Bank in the country's reconstruction effort.

November 18, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Qureshi

DATE: November 5, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

Dubey

EXT: 78073

SUBJECT: SRI LANKA - Policy Framework Paper - Agenda

1. The Operations Committee will meet on Tuesday, November 10, 1987, at 4:00 p.m. in Room E1244 (note change of date and room) to discuss the Policy Framework Paper distributed earlier. This first PFP will be the basis for a SAF and a CFF from the IMF. Discussions on a SAF had in fact begun in September of last year, but a satisfactory PFP could not be agreed upon. The main problem encountered at that time concerned the monitorability of the public sector deficit. This is no longer a problem since accounting procedures and expenditure controls have been strengthened sufficiently.

2. As is well known, far-reaching economic reforms were introduced in 1977-78 after two decades of highly dirigiste policies. The reforms involved sweeping deregulations across all sectors of the economy and elicited a strong response from the international donor community. Thanks to the policy reforms and to the increased availability of foreign resources which led to a doubling of both public and private capital expenditures, the annual average growth rate increased to about 5.6% during 1978-86. There were nonetheless some important policy weaknesses: (i) the expansion in public expenditures was not matched by increases in domestic resources; (ii) much of public expenditures was used for projects with questionnable pay-offs, and (iii) the real exchange rate appreciated continuously until mid-1985.

3. These policy weaknesses, coupled with the ethnic conflict and adverse changes in the external terms of trade, have led to a sharp drop in the growth rate. The public sector and current account deficits have reached levels that cannot be sustained without additional concessionary aid. However, the medium-term program described in the PFP indicates that the GOL has realized the urgency of completing the reform process begun in 1977 by rectifying these macroeconomic imbalances.

4. The Committee might wish to consider the following main issues:

- The adequacy of the program and risks. The basic issue is whether the proposed adjustment program is sufficient, or at least whether due weight is being given to the risk of the ethnic conflict proving to be more costly and disruptive than anticipated and to the risk of adverse political pressures before the next election in late 1988. The projections in Table 2 are very optimistic. In particular, a sharp turnaround in exports has been assumed after the absolute declines in 1985 and 1986; also, despite the projected increases in the GDP growth rate, it has been assumed that imports will remain constant in real terms. Would the Region comment on the realism of the projected scenario, and on the feasibility of additional policy changes and/or external finance that may become necessary?

- Public sector finances. The proposal calls for a ceiling on public sector deficits of 9 or 10% in 1990. Of the various revenue and expenditure measures described, perhaps the most critical ones are the proposed reductions in transfers to loss-making corporations, consumption subsidies and capital expenditures. Annual discussions with the World Bank are proposed to establish expenditure priorities. Even so, the appropriate policy would clearly be to reform the public sector to allow more rational decisions (e.g., by instituting a strong central mechanism for screening the proposals from the numerous ministries). Would the Region comment on the institutional changes needed to enable the GOL to control public expenditures meaningfully and whether such changes can be included in the proposed program? In addition, the Region might comment on the possibility of strengthening the conditionalities on the expenditure side by specifying separate ceilings on transfers, subsidies and capital expenditures.

- Trade and exchange rates. The proposed conditionalities on the reform of tariffs and export incentives are appropriate. However, the GOL's commitment to maintain flexibility in the exchange rate is rather vague. If the program is to succeed, and especially if the down-side risks materialize, the GOL would need a strong commitment to maintaining a realistic real rate. Even though it may not be appropriate to spell out the details in a PFP, the Region might explain the benchmarks with reference to which the GOL and the Bank/Fund will decide on appropriate changes.

- Sectoral Conditions. Some policy conditions on agriculture, energy, and transport are included in the medium-term program. The questions are: (i) is our sector knowledge adequate at this time to allow us to define the conditionalities in a monitorable manner? (ii) do these conditionalities duplicate the covenants of existing operations? (iii) would the required policy changes be better handled through sector adjustment operations?

cc: Messrs. Lee, COD; Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Baneth, IEC; Thahane/Burmester, SEC; Baudon, SVPOP; Burki, ASIVP; Yenal, Huang, Aggarwal, Zagha, ASI.

cc for information: Messrs. Fischer, VPDEC; Bock, DFA; Frank, Parmar, IFC; Goldberg, VPL; (Ms.) Haug, EXC.

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Nov. 5, 1987

The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee to Consider
MOROCCO - Structural Adjustment Loan I;
Initiating Memorandum

CONFIDENTIAL

Held on November 5, 1987 in Conference Room E-3070

A. Present

Committee		Others	
Messrs.	M. Qureshi (Chairman)	Messrs.	Baudon (SVP)
	S. Husain (LACVP)		Bouchet (DFA)
	E. Jaycox (AFRVP)		Brigish (EM2)
	A. Karaosmanoglu (ASIVP)		Burmester (SEC)
	V. Rajagopalan (VPPREj)		DeWitt (LEG)
	H. Scott (LEG)		Dervis (EM2)
	W. Thalwitz (EMNVP)		Dubey (EAS)
	J. Wood (FBPVP)		El Maaroufi (EMN)
			El Serafy (EAS)
			Hadler (FRS)
			Harris (COD)
			Hasan (EMN)
			Hewer (EM2)
			Liebenthal (SPR)
			Michalopoulos (EMN)
			O'Sullivan (EM2)
			Rao (FRS)
			Reif (SPR)
			Shilling (EM2)
			Sacerdoti (IMF)

B. Issues

1. The Operations Committee met on November 5, 1987 to discuss the Initiating Memorandum for a first Structural Adjustment Loan to Morocco in the amount of $200-250 million. The discussion followed broadly the agenda prepared by the Economic Advisory Staff and focused on the timing of the operation; the strategy proposed and the lending program; Bank exposure; the trade liberalization provisions of the SAL (as compared with those under ITPA I and II) and the exchange rate; the revenue impact of the proposed tax changes; and the social cost of the program.

C. Discussion

2. The Region stated that although appraisal would probably take place in April, this meeting was called rather early because a mission was departing for Morocco which would explore the acceptability of the strategy and assess the prospects of the program proposed. Despite the improvement reflected in many indicators, including the current account and the fiscal deficit since the Bank-supported adjustment process began, the process has remained essentially a stabilization one, while growth has hardly exceeded the population increase. Meanwhile total external debt has increased to about 110% of GDP. While the Bank has been lending $500-600 million a year with a heavy slant towards sector adjustment lending, Bank exposure has reached 10% and will grow to 18% by the mid-1990s. The strategy is clearly not working, and what seems to be needed is to accelerate growth to 5% per annum through a better investment effort, while simultaneously raising the efficiency of investment in order to get Morocco to grow out of debt. If the new strategy is successful, in eight years or so the DOD/GDP ratio would fall to 80%, and some improvement in creditworthiness would be evident. Such a strategy would be feasible if Bank-Fund collaboration were to be strengthened further, and a proper set of incentives worked out.

3. The Chairman said that the Region was in effect saying that after several years of Bank-supported adjustment Morocco has a creditworthiness problem and that there is risk to the Bank in terms of high exposure so that continuation along the same path would not be fruitful. He questioned the suggested approach which relied on covering the current account almost entirely by the Bank on a net basis, and stated that very close cooperation with the Fund was necessary, not just in defining objectives, but also on the timing of reforms and above all on monitoring. The Chairman observed that the projected size of the gap was not too large either in absolute terms or in relation to GDP, but the supply response to adjustment had not been all that great. A member, however, said that Morocco's adjustment record with a 3.5 or 4% growth per annum was in fact better than in many other high-debt countries.

4. The Committee queried the burden-sharing implied in the macroeconomic scenario presented by the Region and wondered if the contribution of others to the financing gap could not be expanded. Members asked why the Bank should accept the projected dramatic increase in its exposure, particularly since Morocco was already a high-risk case for the Bank with the Bank debt service representing about 8% of exports. The Region said that every effort would be made during the next several months to increase the contribution of Morocco's other creditors, and to identify possible new sources of financing. It was recognized that Morocco had already availed itself of debt rescheduling and that this might reduce the effective benefits of a new debt rescheduling initiative. The Region further assumed that the Fund would be maintaining its exposure for the next few years, and other creditors would be contacted to ensure their participation. The Chairman concluded the discussion of this issue by stating that a more equitable burden-sharing than implied in the Initiating Memorandum should be reached during the coming months.

5. A member asked if the new strategy might be frustrated by capital flight as has happened in some LAC countries, but the Region emphasized the recent increased inflow of workers' remittances, particularly in response to exchange rate adjustments. The Region added that the private sector was responding well, but overall response was only moderately good, and Morocco continued to meet its debt service obligations. It also said that the Sahara war was a limited military effort and did not represent a "raging war" as suggested in the Agenda. The higher growth sought, together with trade liberalization, would stimulate rather than discourage capital inflows. While the risk is there, the success of the growth strategy would be the best defense against our increased exposure.

6. The Region then gave an account of progress on trade liberalization under the two ITPAs. QRs have been removed except for 12% as weighted by imports and 40% as weighted by production, and the maximum tariff has been reduced from over 200% to 45%. A significant real devaluation occurred in 1984 and 1985, but the real exchange rate was constant in 1986. Perhaps a 2-3% a year real devaluation would be helpful in order to increase competitiveness, but the IMF was leading policy advice in this area. The Region was proposing the establishment of targets for exports and other macroeconomic variables, to be monitored under the SAL.

7. A speaker reminded the meeting that previous undertakings under the ITPAs meant that the special import tax (SIT) applying to all imports with the exception of agricultural goods and temporary admissions was to be reduced in steps from 15 to 10 to 5 and to 0%, and that the Fund had thought that that might lead to a loss of revenue. The introduction of a minimum tariff of 10% as proposed might be construed as a reversal of previous liberalization. A discussion then ensued on whether that would be in fact a reversal: was not this device of a minimum tariff used in other countries to reduce dispersion of effective protection? While such a tax would be tantamount to a devaluation applying to imports, a currency depreciation would work on both imports and exports and would raise the fiscal revenue. The Chairman left it to the mission to judge which course is preferable.

8. Other issues raised included whether conditionality should be strengthened "up front", and the Region said that this was in fact implicit in the delay envisaged for appraisal. The social impact was discussed and this led to a discussion of the social services such as health and education, and the desirability of reviewing both public investment and expenditure as part of the program. The Chairman said that this should be linked to the understanding to be reached on trade liberalization and the fiscal program.

D. Conclusion

9. The Region was authorized to proceed along the lines proposed in the Initiating Memorandum and subject to the discussion summarized above.

SESERAFY/lcu

November 12, 1987

M. Qureshi

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 2, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXT: 78051

SUBJECT: MOROCCO: IM for a Proposed SAL
ECUADOR: Export Development Loan

The Operations Committee will meet on Thursday, November 5, 1987 at 3:00 p.m. in Room E-3-070 on Morocco. An Initiating Memorandum for a first Structural Adjustment Loan for Morocco has already been circulated. An Agenda will be forwarded shortly by EAS.

The meeting on Ecuador - Export Development Loan will now take place at 4:00 p.m. (instead of 3:00 p.m. as stated in the Agenda circulated on October 29, 1987) in Room E-3-070.

cc: Messrs. Lee, COD; Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Baneth, IEC; Thahane/Burmester, SEC; Fischer, VPDEC; Bock, DFA; Baudon, SVPOP; Goldberg, VPL; Frank, Parmar, IFC; Ms. Haug, EXC; Hasan, EMNVP; Dervis, EM2DR; Shilling, EM2CO; Bottelier, Selowsky, Aguirre-Sacasa, Rowat, Eigen, McMullen, LAC.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 3, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXT: 78051

SUBJECT: MOROCCO: SAL I Initiating Memorandum - Agenda

1. The Operations Committee will meet on Thursday November 5 at 3.00 p.m. in Room E-3070 to discuss a proposed first SAL operation for Morocco in the amount of $200-250 million. This SAL would be the seventh adjustment operation since 1983, in support of reforms in trade policy (two loans in FY84 and FY86), agriculture (two loans in FY85 and FY88, the latter being distributed to the Board), education (FY86), and public enterprises (FY87). Some signs of improvement in performance are evident, but the Region argues that "the medium-term prognosis must be judged as precarious" (IM para. 8) and that without continued structural reforms and external support, the achievements made so far and the prospects for growth would be endangered.

Program Onset

2. It is not clear when the fiscal program, which is the core of this operation, will be initiated. The covering memorandum (para. 5) proposes an appraisal mission in early 1988 if Government commitment is judged adequate by an earlier mission. It mentions opposition to the proposed fiscal changes which has forced the Government to delay presentation of the supporting legislation from December 1987 to April 1988, and adds: "This delay forces us to postpone the appraisal." The Initiating Memorandum, however, indicates a life span for the proposed SAL of eighteen months: from January 1988 to June 1989, or alternatively from January 1988 to June 1990 if implementation proves to be less rapid (para. 59). The Region may wish to elucidate:

- When the fiscal reform program is likely to start; is this January 1988, April 1988, or later?

- What does "Government commitment" mean, if the legislation cannot be taken to Parliament?

- If the appraisal is to be delayed to April 1988 or later, is it not too early for the Operations Committee to discuss the IM now?

The Macroeconomy and the Lending Program

3. The Region draws attention (para. 7) to many weaknesses remaining in the Moroccan economy, including depletion of foreign exchange reserves,

chronic external imbalances, the build-up of external arrears, low levels of savings and investment, and the increasing burden of foreign debt. The Saharan conflict continues to rage costing "5% of GDP above the level prevailing in the early 1970s" (IM, footnote to p.2) and the ICOR levels remain at about 7 indicating low productivity investments. Special factors leading to the apparent improvement of the deficits have included massive cuts in public investment, exceptionally favorable conditions that raised agricultural production in 1986, lower interest rates, and improved terms of trade. Even in the areas ostensibly covered already by adjustment, such as trade "liberalization", "QRs still affect 40% of industrial production and most agricultural production" (IM, para 9). Gross investment/GDP has been fairly steady at about 22-23% and is not projected to rise. Domestic savings, boosted by the good 1986 harvest, jumped from 12% in 1985 to 16% in 1986, but interest on foreign debt of about 6% of GDP would have depressed national savings to 10%, except that workers' remittances, equivalent to 9% of GDP, are reckoned as additions to savings, and have thus pushed national savings to about 20% of GDP. The IM states (para. 10) that much of this is being absorbed by the real estate sector or otherwise finances the public sector deficit. As previous Bank operations had not addressed fiscal policy, and since a 1986 joint Bank-Fund mission had identified areas of reforms in the tax structure and administration, the SAL is being proposed as an appropriate vehicle for pursuing fiscal reforms.

4. Adjustment lending has constituted a large proportion of total Bank lending to Morocco which rose to $538 million in FY86, $577.3 million in FY87, and is projected to continue at that high level afterwards ($568.5 million in FY88--of which 75% for adjustment--and about $540 million a year in the following two years). Several adjustment operations are foreseen in the period to 1992, including further loans for agriculture, education, public enterprise and another SAL. Bank exposure, already high is expected to reach 18% by 1995 and its share in preferred creditors' debt will be 25% in 1990. The IM states that "the Bank cannot support such an adjustment program alone" (IM, para. 20) and argues that a SAL is necessary for mobilizing outside support by providing assurances of the "viability of the Government's adjustment program" (para. 24):

- <u>The Committee may wish to discuss whether the adjustment program is in fact "viable" in view of the weaknesses enumerated above, and the necessity of continuing to process quick disbursing adjustment operations apparently without limit</u>.

- <u>Is the saving investment effort satisfactory and the low productivity of investment consistent with the adjustment objective</u>?

- <u>How realistic is the Region's assessment of capital inflows and further rescheduling from commercial and other sources</u>?

- <u>And is the projected increase in Bank exposure acceptable</u>?

The SAL Program

5. The program to be supported by the SAL, though with a hard fiscal core, covers a wide front including "further liberalization of trade", "further rationalization of public expenditure", strengthening planning capabilities, and developing capital markets. Annex III contains eleven pages of policy reforms, including eight on tax and budgetary reform and two on trade reform. A separate public administration loan would complement the SAL, providing technical assistance and financing studies and computerization of activities with the objective of strengthening the statistical services, enhancing capabilities for monitoring short-term macroeconomic developments, improving planning and modelling, developing industrial policies and improving public investments and administration.

6. In the area of trade reforms the program suggested would eliminate "most" of the remaining QRs by January 1989, unify the trade tax system with a maximum rate of 60% (said to be equivalent to the 45% maximum agreed under the ITPA loans), and coordinate trade liberalization for the agricultural and industrial sectors. Proposed conditionality would include affirmation of the flexible exchange rate policy. The trade conditionality appears to go over familiar ground already covered by previous loans. In view of the fact that the IM does not evaluate trade liberalization as achieved under previous operations and as covered by current operations such as the second Agricultural Sector Adjustment Loan whose conditionality has been diluted at the grey cover package stage:

- The Region may wish to present a cogent assessment of progress so far achieved on trade liberalization under previous operations and indicate precisely what is to be expected under the SAL in comparison with commitments already made.

- The Region might also wish to elaborate on the current level of the exchange rate and whether in view of the recent setback of industrial exports further depreciation of the Dinar might be necessary.

7. The fiscal proposals would raise tax revenues by simplifying the VAT rate structure, reducing the number of rates, and improving collection rates. They would also simplify and improve collection of corporate taxation and personal income taxes. Double taxation of individuals would be eliminated, and tax rates consolidated on different types of income and the number of taxpayers reduced by tax relief on lower income groups. Tax administration reforms are also being pursued. The IM expects "a small revenue loss in the initial phase of the adjustment program" (para. 37). Annex II assesses the impact of the change on revenue, and this clearly shows a significant reduction of personal income tax revenue in 1989 and 1990. Most of the increased revenues are projected to come from the tariffs on imports when the rates are adjusted and the QRs reduced:

- The Region may wish to throw light on the basis for calculating this projected increase of revenue from trade taxes and assess the implications to the program of reduced overall revenues in case such an increase did not materialize.

Social Impact and Loan Size

8. The IM draws attention to the increase of the social costs as a result of the program. This part of the IM is too brief to enable a proper assessment of program impact:

- The Region might give some detail of the program worked out with the Government "to offset losses to the poorest due to food subsidy reduction", and the establishment of the nutritional safety net mentioned in para. 51.

9. The loan amount is proposed at $200 million, but the government is pressing for a larger amount. In view of the fact that the second Agricultural Sector Adjustment Loan has been raised from $200 million to $225 million, is there justification also for increasing the amount of this loan?

cc: Messrs. Lee (COD), Shakow, Liebenthal (SPR), Holsen (CEC), Rao, Steer (FRS), Baneth (IEC), Thahane/Burmester (SEC), Baudon (SVPOP), Hasan, Dervis, Shilling (EMENA), El Serafy (EAS).

cc for information: Messrs. Fischer (VPDEC), Bock (DFA), Frank, Parmar (IFC), Goldberg (VPL), Ms. Haug (EXC).

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

Mr. Qureshi

OFFICE MEMORANDUM

DATE: October 29, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXT: 78051

SUBJECT: ECUADOR - Proposed $50 million Export Development Loan Initiating Memorandum - Agenda

1. 4:00 The Operations Committee will meet on Thursday, November 5, 1987 at 3:00 p.m. in Room E-3-070 to discuss the Initiating Memorandum for a proposed $50 million Export Development Loan to Ecuador. The Operations Committee may wish to discuss the issues raised in paras 3 to 6 below.

Background

2. Significant progress has been made during the past few years in liberalizing Ecuador's trade regime and financial markets. The process has been helped by reasonably good fiscal and monetary management and a floating exchange rate. However, a strong anti-export bias remains impeding the diversification and rapid growth of Ecuador's exports. The government intends to take an important step towards a more open trade regime by reducing quantitative restrictions and import tariffs and granting free-trade status to exporters while maintaining the current highly competitive exchange rate. The Region proposes to support this program with a $50 million Export Development Loan which would be disbursed in one tranche.

Size of Loan and Timing

3. General elections are scheduled for January 1988, with a possible runoff in May and inauguration of the new President in August. Current expectations are that the opposition parties would win which implies a considerable risk that current economic policies could be abandoned or considerably modified. The Region proposes to make a modest $50 million one-tranche loan to support the current government's liberalization program, and it hopes that the new government would stay the course which then could be supported by a second loan. While all measures considered under the loan would be conditions for Board presentation, Board action is not expected until March 1988 when the current government will be already in lame-duck status. The question arises whether, given the great risks involved in the proposed operation, the loan should not be postponed till the new government comes into office. Alternatively, the Operations Committee may also consider the possibility of a larger loan with two tranches, since the possibility of a (highly publicized) cancellation of a second tranche might be a stronger deterrent against major policy changes by the new government than the prospect of losing a new loan.

Should we have a larger loan with 2nd tranche?

Medium-term Financing Plan Elaborate on it

4. The proposed loan, together with the (further advanced) proposed financial sector adjustment loan, would be an important element in Ecuador's external financing plan. The Committee may wish to ask the Region to elaborate on the medium-term financing plan and have a firm picture at the green cover stage showing the anticipated contributions from different sources including the IMF so as to put Bank resource flows and exposure into a clear perspective.

Trade and Exchange Rate Management

5. The free float of the sucre resulted in a major real depreciation. While this has greatly helped export competitiveness, additional trade liberalization measures are considered under the loan to reduce the strong anti-export bias. In this context several questions arise:

(a) In light of the strong depreciation of the real exchange rate, could not QRs be reduced by more than a third (as proposed in para. 5.8) and the maximum tariff by more than 25-30% (as proposed in para. 5.9)? Particularly re QRs

(b) What is the nature of the remaining export prohibitions mentioned in para. 5.6?

(c) Given the paramount importance of a competitive exchange rate for export development and overall economic growth, would it not be desirable to establish a specific scheme to sterilize future petroleum price windfalls to maintain the current real exchange rate even when petroleum prices rise? Nothing there yet

Social Impact

6. The adjustment measures taken during the past several years and those proposed under the loan must have a major differential impact on different social groups. Could the Region provide some information on current or future government programs to mitigate this impact. Are there any operations in the planned lending program that address the issue? Should any new action or continuation of ongoing programs be formally linked to the proposed operation?

cc: Messrs. Lee, COD; Shadow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Baneth, IEC; Thahane/Burmester, SEC; Bock, DFA; Baudon, SVPOP; Fischer, VPDEC; Frank, Parmar, IFC; Bottelier, Selowsky, Aguirre-Sacasa, Rowat, Eigen, McMullen, LAC; Ms. Haug, EXC.

UThumm:vlw

October 22, 1987

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Qureshi
23667
10/19
1

DATE: October 19, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V.Dubey

EXT: 78051

SUBJECT: CHILE - Structural Adjustment Loan III
Green Cover Package - Agenda

1. The Operations Committee will meet on Thursday, October 22, 1987 at 3:00 p.m. in Room E-1208 to discuss the green cover package for the proposed Third Structural Adjustment Loan to Chile. The Operations Committee may wish to discuss the issues as set out in paras 3-6 below.

Background

2. The proposed $250 million loan would be the last one in a series of three SALs which the Bank committed itself to. It is also a condition of effectiveness for the 1988-91 rescheduling of public debt with commercial banks. The proposed loan would support (i) a continuation of sound macro-economic management emphasizing export promotion and solid public finances; (ii) the strengthening of long-term capital markets, particularly by putting pension funds on a healthier basis; (iii) the enhancement of social security; and (iv) the improvement of the health care system. The green-cover package is in line with the OC's mandate and addresses the concerns previously raised. However, some issues remain.

Macroeconomic Management

3. Chile's medium-term economic prospects and creditworthiness critically depend on the soundness of macroeconomic management and export performance. Fiscal and exchange rate management are obviously of particular importance. While performance has been good and the performance targets for the future appear to be adequate, several questions could be raised:

(i) The Copper Stabilization Fund established in 1985 is an important tool for fiscal and balance of payments management. While the proposed measures will strengthen the fund, they may not be sufficient to contain the risks for fiscal and exchange rate management resulting from a possible substantial copper price increase. Can the Region elaborate on the present and proposed future operation of the fund and discuss possible outcomes under two different scenarios, with current price projections and a higher price as suggested in para. 90 of the President's Report?

(ii) The performance of non-copper exports is another key element in the medium-term growth scenario, and it is proposed to modify incentives if export growth were lower than 6% in 1987 and 7% in 1988. Can the Region elaborate on the specifics of a possible modification of incentives?

P-1867

(iii) The public investment program is an important factor in determining the level of aggregate demand and future growth prospects. Would it not be more prudent to set an investment target lower than the 7.5% of GDP envisaged for 1988, given the downside risks spelled out in para. 91 of the President's Report? Moreover, could the Region give additional information on the current and future public investment program and the justification of some of its components (including housing and Santiago Metro)?

?, V

Composition

Social Program

4. The strengthening of the government's social programs is a key feature of the adjustment program to be supported by the proposed loan. Many measures are proposed to improve health service delivery. How does the Region propose to monitor some of the specific conditions for second tranche release (e.g., strengthening of preventive health care, incentives for cost containment)?

5. The milk distribution program is considered important for the reduction of child malnutrition. Yet, a good part of the program is not very effective. Could better targeting of the milk program become an additional loan condition?

Financing Plan

6. At the July 27, 1987 Policy Committee meeting, Mr. Conable emphasized that the release of the second tranche of the proposed loan should be conditioned on the availability of suitable complementary financing. This suggests adequate financing beyond the end of 1988. Yet, the Region projects a financing gap of $300 million for 1989 and 1990, with considerable risks for an even larger gap. In the projected scenario, IMF exposure will be reduced while that of other creditors or groups of creditors is not explicitly shown. Could the Region elaborate on the financing plan and the prospects for complementary financing to fill the gap. Should we have a formal condition for second tranche release?

cc: Messrs. Lee, COD; Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Baneth, IEC; Thahane/Burmester, SEC; Bock, DFA; Baudon, SVPOP; Frank, Parmar, IFC; Selowsky, Bottelier, Eigen, Newfarmer, LAC.

UThumm:vlw

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 5, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXT: 78051

SUBJECT: CHILE - Structural Adjustment Loan III
Green Cover

The Green Cover Report for the Chile Structural Adjustment Loan will be discussed at an Operations Committee meeting on Thursday, October 22 at 3 p.m. in Room E-1208. An agenda for the meeting will be issued shortly.

cc: Messrs. Thahane/Burmester
Lee
Shakow
Holsen
Rao
Baneth
Steer
Ms. Haug

October 20, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Qureshi

Ra

Date: October 13, 1987

To: Operations Committee

From: Vinod Dubey, Director, Economic Advisory Staff
V Dubey

Extn: 78051

Subj: INDIA: Drought Assistance Operation - Agenda

1. A meeting of the Operations Committee will be held on October 20, 1987, at 3.00 p.m. in Room E-1208 to discuss the proposed operation.

2. India's encounter with one of the severest droughts in many years has prompted it to seek Bank assistance so that this drought will not have serious effects on the economy and on the process of growth and adjustment that the Government is trying to sustain. The budgetary and balance of payments costs of drought relief works are enormous. On top of this, the social costs are also likely to be huge. While the proposed project is essentially a balance of payments support operation, it will also indirectly assist some of the poorest sections of the population in drought-affected areas by supporting the increase of budgetary resources available for emergency drought relief operations. In considering the proposed request, the Operations Committee may wish to discuss the following:

Government Commitment to Drought Amelioration Program

3. Agriculture dominates the economy, accounting for about two-thirds of labor force and over a quarter of GDP. About 40% of India's population continues to live below the poverty line. Indian agriculture faces many challenges including further development of irrigation, better water management, more intensive use of new technology, efficient delivery of inputs and services and appropriate pricing policies. The seriousness of the present drought situation has clearly established the need to improve India's resilience to the uneven and highly variable incidenceof the rains.

- Can the Region elaborate on the steps that the Government wishes to follow for integrating drought amelioration measures into overall medium-to-long-term agricultural policies?

- Has the Government been following a satisfactory grains stocking policy and efficient agricultural products storage and distribution practices? If not, does the loan propose to address these issues?

Related Actions in the Government Investment Programs and the Bank's Existing Portfolio

4. In order to overcome some of the critical constraints on agricultural production, it is necessary to supplement the proposed emergency assistance with a few additional and reinforcing measures.

- How likely is the Government to effect changes in its investment policies to speed up the implementation of ongoing drought amelioration projects or broaden the scope of projects to make them more responsive to the challenges and critical constraint on agricultural production arising from the drought? How does the Region propose to reorient its lending program to support these adjustments?

Additional Considerations

5. In light of the fact that the estimated budgetary cost of debt relief works is expected to exceed US$1.6 billion and the balance of payment cost $1.0 billion, could the region explain the rationale for recommending US$300 million as the loan/credit amount of the proposed operation?

6. While the proposed operation has many features of a program-type and SAL-type operation, nevertheless it remains a special type of drought related, development assistance. Under these circumstances, why should not disbursement be against directly or indirectly drought-related imports?

7. The balance of payments and budgetary effects of the drought will be spread over the next several months. Meanwhile, the Bank has to be satisfied with the Government's drought amelioration programs as well as its grains storage and distribution policies. For these reasons, is not there a case for tranching the proceeds of the proposed loan/credit and making sure that some of the necessary adjustments in policies, programs and projects modifications are followed through?

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. [illegible]
E-1241
23589
10/13

DATE: October 9, 1987

TO: Mr. Attila Karaosmanoglu, ASIVP

FROM: Ibrahim F. I. Shihata, LEGVP

EXTENSION: 74945

SUBJECT: INDIA: Drought Assistance

1. I refer to the proposed Drought Assistance Loan/Credit to India, to be considered by the Operations Committee on October ~~15~~ 20, 1987.

2. The proposal seeks to respond to India's critical need to overcome losses arising from the recent drought in that country. The special circumstances in which this operation is being prepared call for assistance that is quick disbursing and directed towards meeting some of the most urgent financial requirements generated by the drought. The current proposal is to meet these objectives by providing an adjustment type loan to finance general imports subject to the standard negative list of prohibited imports, with procurement arrangements following those generally used for structural adjustment.

3. As you are aware, however, the SAL lending instrument is to be used to support specific policy changes and institutional reforms to achieve efficient use of resources and contribute to a sustainable balance of payments in the medium and long term, while maintaining growth. It is also necessary that agreement must be reached with the government on precise actions to be undertaken according to an agreed schedule over the adjustment period (OMS 2.01 dated February 1987). As it is not proposed to obtain significant assurances from the government regarding policy actions, it does not appear that the proposed operation should be considered a structural adjustment operation. In order to provide a rehabilitation import loan to stabilize the economy following the drought (financing general imports, subject to the negative list), it would be necessary to reach agreement on an effective stabilization program and complementary up-front actions (OMS 2.01). Again, the current proposal does not appear to fit into this category, in the absence of monitorable agreements on policy actions. In view of the above, I would have difficulty supporting the proposed operation, as currently conceived, as an adjustment loan.

4. In the past, the Bank has responded to similar natural and economic emergencies in one of two ways. First, by financing general imports subject to the negative list to support a clearly defined program and based on agreement on a series of actions to be undertaken by the Government. Second, by financing a positive list of specific items which are urgently required as a direct consequence of the emergency. I have no problem with either option. The latter option does not necessarily require obtaining assurances on policy actions.

5. Under the circumstances, it may be advisable to achieve the Bank's objective of assisting India in overcoming losses arising from the drought by providing a loan to finance a positive list of imports that are critically needed by India to overcome the effects of the drought. Procurement and disbursement arrangements could be structured so as to ensure maximum speed in implementation. Further, assurances would be sought that the imported items would be utilized as part of identified drought recovery activities. This would also eliminate the need to introduce policy conditionality at this stage, for this operation.

6. Proceeding with the loan as proposed would, in my judgement, create a bad precedent that could unduly complicate our future policy based lending operations.

cc: Members of the Operations Committee

August 28, 1987

Mr. Qureshi

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE : August 24, 1987

TO : Operations Committee

FROM : Vinod Dubey, Director, EAS

V Dubey

SUBJECT: Discussion of Somalia - Agricultural Sector and Adjustment Program II (ASAP II) - Initiating Memorandum.

A meeting to discuss the Initiating Memorandum for the Somalia Agricultural Sector and Adjustment Program II (ASAP II) will take place on Friday, August 28 at 4:30 p.m. in Room E-1208. This document was circulated to you under Mr. Jaycox's signature on August 19, 1987. An agenda for the meeting will be issued shortly.

cc: Messrs. D. Lee
A. Shakow
J. Holsen
D.C. Rao
J. Baneth
R. Frank
J. Parmar
D. Bock
J. Shivakumar
C. Madavo
S. O'Brian
S. Denning
K.Y. Amoako
F. Laporte
Ms. Veronica Li

DMahar:pl

Mr. Qureshi
cc TB

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE : August 25, 1987

TO : Operations Committee

FROM : Enzo Grilli, Acting Director, EAS EG.

EXTENSION: 78061

SUBJECT : Somalia - Agricultural Sector and Adjustment Program II (ASAP II); Initiating Memorandum - OC Meeting Agenda

1. The Operations Committee will meet on Friday, August 28 at 4:30 p.m. in Room: E-1208 in order to discuss the above-referenced document which was circulated on August 19, 1987 under separate cover. The proposed IDA credit in support of ASAP II would be for $53 million. The African Development Bank intends to contribute an additional $20 million. The Committee may wish to consider the following:

Background

2. The Government of Somalia (GOS) has since 1981 enacted a series of economic reforms aimed at reducing the country's large internal and external imbalances within a context of economic growth. These efforts have been supported by the IMF through successive Stand-by Arrangements (the latest approved in June 1987) and a Structural Adjustment Facility (SAF), and by IDA through the ASAP I (approved in June 1986). Progress to date has included the establishment of a foreign exchange auction, trade liberalization, and substantial reductions in controls over agricultural pricing and marketing. While this package of measures has contributed to a growth in per capita GDP averaging 2 percent p.a. since 1981, improvements in the country's public finances and balance of payments situation have proven to be far more elusive. Somalia remains highly dependent on external assistance for financing its large trade and budgetary deficits, and it is likely that this state of affairs will change only gradually in the coming years.

Prospects for Medium and Longer-Term Economic Growth

3. Given Somalia's harsh natural environment, extremely low education and health standards, high population growth rate, and limited prospects for the country's principal economic activity (livestock), attaining self-sustained growth in the medium to longer terms will be difficult. The Initiating Memorandum (IM) states that the appropriate long-term strategy must be based on sustaining growth in banana exports and creating the conditions necessary for promoting other high-value agricultural exports (para. 17). The promotion of agricultural processing industries is also mentioned as part of the strategy (para. 17).

> Will the attainment of diversification and sustained growth require large new public investments? If so, what are the Region's views on the economic and financial justifications for such investments?

<u>The Region may want to brief the Committee on the overall thrust of the Bank's lending program for Somalia, placing emphasis on the complementarities between ongoing and proposed operations and ASAP I and II</u>.

<u>Incentives</u>

4. One of the key objectives of ASAP I has been the liberalization of foreign trade. It is apparent that considerable progress has already been achieved in this area. As reported in paras. 13 and 30 of the IM, most quantitative controls on foreign trade have been removed. In light of this recent progress, it is not entirely clear why the Region is recommending an increase in tariffs on grains and flour from 17 percent to 40 percent (para. 30), particularly <u>before</u> the proposed tax and tariff study is carried out.

<u>The Region may want to explain to the Committee the economic rationale for raising tariffs on grains and flour.</u>

<u>Public Expenditures</u>

5. The present state of Somalia's public finances as portrayed in the IM is alarming. The deficit is very large--expected to reach 22.4 percent of GDP in 1987--and it would appear that widespread accounting deficiencies make fiscal analyses and economically-rational budgetary decisions almost impossible (para. 32). In order to help improve Somalia's public finances, the IM recommends as a condition of effectiveness that the PIP be reduced selectively by 30 percent in accordance with decisions taken at the April 1987 CG meeting (paras. 33 and 55).

<u>Given the present serious deficiencies in fiscal management, is it realistic to expect the GOS to meet the condition of effectiveness regarding public investment in an expeditious manner? What steps does the Region plan to take to improve the Government's capacity in this area?</u>

<u>If the GOS is to be committed to reducing appreciably the size of the PIP, why does Annex A show a rising Public Investment/GDP ratio over the 1987-89 period?</u>

<u>Agricultural Sector Actions</u>

Veterinarians and Veterinary Drugs

5. The IM argues that the present prohibition of private practice has restricted the national supply of veterinarians (para. 42). Though this issue was raised with Government at ASAP I appraisal, no action was taken because the then-Minister of Livestock, Forestry and Range felt that the "time was not appropriate" (para. 42). The Region now believes that such action is now feasible and recommends as second tranche conditions: (i) the implementation of licensing arrangements for private veterinarians (paras. 42 and 58); and (ii) the liberalization of trade in injectible veterinary drugs (paras. 43 and 58).

In light of the overwhelming economic importance of livestock in Somalia, and the present critical shortage of veterinarians, the Region may want to explain in more detail why the conditions pertaining to the legalization of private practice and the liberalization of trade in veterinary drugs must be delayed until the second tranche.

Processed Hides and Skins Exports

6. The IM states that Government monopolization of exports of processed hides and skins costs the economy between $5 and $10 million annually. If further states that while domestic trade in these products was decontrolled under ASAP I, the GOS could not agree, for essentially political reasons, to export decontrol (para. 44). The IM recommends that export decontrol be a second tranche condition of ASAP II (paras. 44 and 58).

The Region may want to brief the Committee on the nature of the political constraints to export decontrol of hides and skins. What has changed that makes the Region believe that export decontrol is now possible? If the political climate is presently favorable, why can't concrete action be taken sooner?

Support for Foreign Exchange Auction

7. According to para. 64 of the IM, about 90 percent of the resources from the proposed ASAP II ($66 million including expected co-financing from the African Development Bank) would be used to support the enhanced foreign exchange auction. However, the IM provides no estimates of the total projected volume of transactions on the auction market, nor does it indicate how these transactions would be financed. Moreover, there is no discussion of the Region's expectations regarding the types of goods that would be imported with financing from the auction.

What does the Region expect the total volume of transactions under the auction to be? How much does the Region expect the GOS to contribute to the auction? What are the medium to long-term prospects for the auction system if exports do not grow as expected?

Why, contrary to expectations, were the bulk of imports financed from the auction under ASAP I food items and consumer goods? Does the Region expect the structure of imports to be different under ASAP II? If so, why?

cc: Messrs. D. Lee, A. Shakow, J. A. Holsen, D.C. Rao, J. Baneth,
R. Frank, J. Parmar, D. R. Bock, J. Shivakumar,
C. Madavo, S. O'Brien, S. Denning, K.Y. Amoako, F. Laporte,
Ms. Veronica Li

DMahar:pl

August 19, 1987

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Date: August 17, 1987

To: Members of the Operations Committee

From: Vinod Dubey, Director, Economic Advisory Staff

Ext: 78051

Subject: GRENADA - Policy Framework Paper

1. The Operations Committee will meet on Wednesday August 19, 1987 at 3.00 p.m. in Room E-1244 to discuss the draft Policy Framework Paper (PFP) for Grenada. A Bank mission is scheduled to depart early next week to coincide in the field with an IMF mission. The PFP covers the three-year period 1988-90. A Fund Structural Adjustment Facility operation and an IDA Structural Adjustment Credit (possibly in a blend with IBRD resources) are being considered.

Background

2. Grenada is an island of some 97,000 people, with a level of per capita income in excess of $1,000. It has a predominantly service economy where manufacturing is rudimentary and tourism, government service and agriculture are the largest activities. Both the balance of payments and the budget are highly dependent on grants and other concessional aid, and unemployment is about 20% of the labor force. In 1986 the overall central government deficit was 6-1/2% of GDP, and the balance of payments current account deficit 7-1/2%. Foreign debt amounted to 43-1/2% of GDP and scheduled debt service to 10-1/2%. The PFP outlines a general program of policy reforms to raise savings, improve the fiscal balance and encourage exports through better incentives. Because of the constraints on Grenada's freedom to adjust the exchange rate, imposed by membership of the CARICOM, currency depreciation is ruled out, and exports have to be affected directly by such methods as raising productivity and cutting production costs, including wages.

IDA Eligibility and Creditworthiness

3. Countries that are IDA-eligible qualify for access to the IMF Structural Adjustment Facility. The PFP has thus to set the stage for both IDA and SAF lending. It will be recalled that in 1985, in the course of the mid-term review of IDA7, it was agreed with the Board that during IDA8 Grenada, as well as a few island economies whose per capita income levels exceed the IDA cut-off limit, would have access to IDA resources only on "a temporary and exceptional basis", and specifically in order to "finance projects and adjustment programs in these countries designed to strengthen creditworthiness." [IDA/RPL/86-1.] While many of the reforms described in the PFP might improve creditworthiness and reduce

dependence on outside grants, the PFP stresses (para.27) that the country will remain vulnerable to external shocks, and that Grenada's dependence on concessional external assistance may persist beyond the medium term. The improvement in the fiscal balance and the current account deficit between 1986 and 1990 as projected in Table 3 (p. 16) appears ambitious: before grants, the Central Government balance reduces from 25.4% of GDP to 10.3%, the current account balance from 27.8% to 15.3%, and external grants from 19.0% to 7.2%. Not much change is envisaged in the debt service ratio or the ratio of interest payments to exports over the same period. The Region may wish to elaborate on:

- <u>the impact of the proposed reforms on Grenada's creditworthiness during IDA8 and beyond</u>;

- <u>Whether the rapid improvements projected in the fiscal and external deficits are realistic</u>; and

- <u>whether the external financing requirements in para. 27 are consistent with the projected decline in external grants</u>.

<u>Program Objectives and Policy Adjustments</u>

4. The paper lists eight objectives to be pursued in the context of the 3-year program. These comprise fiscal reforms; privatization of public enterprises and restructuring of statutory bodies; limiting government's borrowing from the national insurance scheme; improving local capacities to formulate the public investment program; banking sector and interest rate reforms; various sector policy changes aiming <u>inter alia</u> at rationalizing and improving the trade regime, land use, agricultural activities, private sector investment, and tourism; improving debt management; reviewing the exchange rate with other members of the Eastern Caribbean Central Bank; and bolstering Grenada's statistical services. While these reforms appear useful, the PFP does not bring out the link between these disparate reforms and the outcome in terms of the projected GDP growth of 4% a year; the envisaged increase of private sector activity and the 12% a year growth in tourism receipts.

where will focus your efforts

- <u>The Region might identify the sources of the projected increase in private sector activity and indicate the likely growth of the important agricultural sector. Beyond extending and improving infrastructure, why should tourism expand at the projected high rates</u>?

<u>Wages and Employment</u>

5. Reducing the unit cost of labor would seem to be the most promising policy instrument available in the conditions described in the PFP and characterized especially by the fact that the exchange rate cannot be freely manipulated. Both for the purposes of demand management and to enhance the comparative advantage of Grenada over the medium and longer terms, wage levels need to be adjusted, and public sector employment curbed. The high levels of consumption and the depressed levels of savings appear to be encouraged by unsustainably high wage rates. The PFP does

does not contain a systematic analysis of the labor market, a diagnosis of the origins of the high incidence of employment or an integration of the wage-employment situation in Grenada's future growth. References to wages are scattered and mainly confined to the public sector. In para. 6 the PFP states that wages in the unionized nonagricultural private sector had increased at an annual average rate of 11 per cent in the period 1982-86, as did Government wages until these were frozen in 1985. "Government and civil service unions are negotiating retroactive wage increases for 1986-87." To achieve a sustainable fiscal position the adjustment program includes implementation of the civil service retrenchment plan for 1987-88 to reduce government employment through voluntary retirements and enhanced severance pay, and to maintain the wage bill at a lower level in 1989-90.

- The Region might wish to throw light on whether the apparently high structural unemployment is due to pressures of unionized labor to raise the wage levels unduly. Wage level

- Could the Region assess the chances of retroactive wage increases for the civil servants for 1986-87?

- And are there practicable ways to reduce the imperfections of the labor market to raise employment and bring the wages down to approach equilibrium levels?

Technical Assistance and the Lending Program

6. The Bank and the Fund have already assisted in the preparation of the Public Sector Investment Program (PSIP) for 1987-90 which will largely be financed from outside sources. Need to strengthen the process of preparing an annual PSIP and selecting individual projects indicates that "technical assistance in these areas is a top priority." (PFP, para.29). Various reforms mentioned in the PFP, including strengthening the Inland Review Department, preparation of a comprehensive land-use plan, improving the statistical services and the country's capacity to plan and monitor development would seem to require concerted technical assistance, possibly financed by outside donors.

- The Region might explain if technical assistance would be forthcoming from other donors in the requisite quantity and quality, and whether the Bank might be called upon to contribute, and how much resources would be involved.

- Apart from the Structural Adjustment Credit, probably to be processed in FY 1989, what other lending if any is contemplated for Grenada in the years 1988-90? [illegible]

cc: Messrs. Loh, Selowsky, Voyadzis, Page, Flood (LAC); Steer (FRS); Liebenthal, Holsen (PPR); Ryrie (IFC); El Serafy (EAS).

SESerafy/lcu

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Qureshi
E1241

DATE: August 13, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS
VDubey

EXT: 78051/2

SUBJECT: Grenada - Policy Framework Paper

The attached Policy Framework Paper for Grenada will be discussed at an Operations Committee meeting on Wednesday, August 19 at 3 p.m. in Room E-1244. An agenda for the meeting will be issued shortly.

Attachment

cc: Messrs. Lee
Shakow
Holsen
Rao, D.C.
Baneth
Loh
Voyadzis

cc for information: Mr. Frank
Mr. Parmar
Mr. Bock

P-1867

August 12, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr Qureshi E1241

DATE: August 10, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, Economic Advisory Staff

V.Dubey

EXT: 78051

SUBJECT: COLOMBIA: Power Sector Adjustment Operation - Topics for Discussion

1. The Operations Committee will meet on Wednesday, August 12, 1987 at 11:00 a.m. in Room E-1208 to consider the Colombia - Power Sector Adjustment Operation.

The Policy Content and Government Commitment

2. This operation was processed as an investment loan, and the authority to invite negotiations was sought on that basis in May. The Region has now proposed it as an adjustment operation for the power sector. It would address a range of difficult issues in that sector, including institutional coordination, investment programming, tariff structures and utility finances. It would also support reductions in power system losses, elimination of public sector arrears, and strengthening of environmental and social planning. The various reforms would be confined to the power sector, except for the creation of the Energy Board which would control investments throughout the energy sector.

3. While the macroeconomic performance of the country has been satisfactory, the discussions on the release of the second tranche of the TAP loan were difficult. The power sector in Colombia has also been a difficult one for many years. This is evident from the very long delay in making the second Bogota Distribution Project effective (its effectiveness is now being sought--after 20 months--as a condition of Board presentation of this loan). In view of this, the Region might explain how likely it is that the Government will pursue all the proposed tariff and institutional reforms in a timely manner. Are we overloading this loan with conditionalities?

Institutional Reforms

4. Fragmentation of decision-making has beset the energy sector in Colombia, leading to excessive investments and inefficient tariff policies. This loan would go part of the way in rationalizing sector planning. The proposed Energy Board would control investment decisions across the energy sector as a whole; ISA would own, construct and operate all major generation and transmission projects within the power sector and continue to have responsibility for sector planning; and JNT (the national public utility tariff board) would have the authority to establish financial and

operational performance indicators and to monitor the power utilities, in addition to its authority to set power sector tariffs. However, neither the Energy Board nor the JNT would deal with tariff and performance issues in other parts of the energy sector (coal, gas and petroleum). Given the strong interdependence of policies in different parts of the energy sector, the proposed reforms might be far from adequate. There is a clear danger that in supporting piece-meal institutional reforms that would preserve most of the fragmentation in the energy sector, this loan would jeopardize our chances of getting a more thorough overhaul of that sector. The Region might explain the master plan for the energy sector as a whole and how the proposed reforms fit into that plan.

Tariff Reforms

5. This loan is proposing progressive convergence to "long-run marginal costs (LRMC)" in reforming tariff policies. As is well known, however, the use of LRMC to guide tariff policies assumes that investments will be optimally planned and executed in a timely fashion. Major departures from LRMC may be justified in periods of excess capacity (recent years in Colombia) and in periods of shortage (1981-82). Moreover, tariff and investment policies in the rest of the energy sector have a direct bearing on the appropriate tariff policies within the power sector. A case in point is that this loan is proposing tariff increases for poor consumers on the assumption that compensating increases in the availability of LPG will somehow take place. The Region might explain the capability of JNT in tariff policy, and also the process by which the tariff policies in different parts of the energy sector will be harmonized.

Parallel Financing

6. A basic objective of this loan is to ensure the viability of the sector's finances through cofinancing. A condition for effectiveness is that $250 million of cofinancing funds be committed; the second tranche release will require another $250 million of cofinancing. Should cofinancing fail, we would require viable alternative actions by the Government. The Region might explain the nature of the contingency plans that it has in mind and their probable effects on the foreign debt profile and public finances.

Financial Plans for ICEL and CORELCA

7. Among the main utilities, the ICEL and CORELCA groups of companies face the worst financial problems. Their financial restructuring is essential both to the design of the loan and to the reorganization of the power sector. Mr. Stern, in his memorandum to Mr. Knox of May 28, had advised delaying the negotiations until satisfactory restructuring plans had been agreed. At this time, a preliminary and incomplete plan has been received from CORELCA. The ICEL plan is expected shortly. The Region might comment on the status of these plans and on whether the invitation to negotiate should be further delayed until we can agree with the Government that they are satisfactory.

Disbursement

8. There is also a disbursement question. Initially, almost half of the disbursements were to be against interest during construction on our past loans. The Region decided this was not a suitable mechanism, and hence it is now proposing disbursements against general imports, subject to a negative list. It may be more desirable to finance a time slice of an approved public sector investment program as was done in the Pakistan energy sector adjustment operation. We understand that this is not being considered because the intention is to reserve project components for other donors. However, given the large size of the annual investment programs, would the Region explain the various options in this regard?

cc: Messrs. Lee, Shakow, Holsen, Rao, Baneth, Frank, Parmar, Bock, Baudon.

ARay:vlw

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

22974
08/06
1

DATE: August 6, 1987

TO: Moeen A. Qureshi

FROM: Vinod Dubey V. Dubey

EXT: 78051/2

SUBJECT: Colombia - Power Sector Adjustment Operation

I do not believe that an OC meeting is necessary on Colombia. However, it would be useful for you to have a discussion with Mr. Husain and his staff. I believe that Mr. Rajagopalan (PPR) should also be invited to the meeting. Mr. Ray's memorandum (attached) would provide the agenda for discussion.

Attachment

cc: Mr. Husain (o/r)
Mr. Loh

OFFICE MEMORANDUM

DATE: August 6, 1987

TO: Mr. Vinod Dubey, Director, EAS

FROM: Anandarup Ray, Advisor, EAS

EXT: 78073

SUBJECT: COLOMBIA - Power Sector Adjustment Operation

1. In his memorandum to Mr. Knox, dated May 28, Mr. Stern had raised the following set of issues (when it was being considered as an investment loan):

a) the need to receive and review financial restructuring plans for the power companies and a plan for reducing arrears prior to inviting negotiations;

b) the need "to be clearer about the Government's macroeconomic intention and a timeframe for action";

c) the need to develop explicit financing proposals with both export credit agencies and commercial sources of credit; and

d) the need to ensure that the proposed institutional measures are "fully adequate".

2. In addition to these issues, the current proposal raises the issue of whether this operation can be reclassified as a sector adjustment operation.

3. The answer to issue (a) is that the Region intends to comply with it. The idea behind seeking negotiation authority at this time is that the ICEL plan is shortly expected, and that the preliminary and incomplete CORELCA plan that has been received can easily be turned into a satisfactory one. You might wish to recommend that the invitation be not sent until both plans have been judged to be satisfactory. Given the current expectations of the Region, this should not cause much of a hiatus.

4. On macro economics (issue b), the questions on the general program were reviewed in the context of the TAP second tranche release. While the second tranche release was authorized, I understand that it was a marginal case. The 20-month delay in making the Bogota Distribution project effective, because of tariff issues, is also worth noting in this connection.

5. Regarding issue (c), the Region has further explored financing arrangements to meet the financial needs of the sector (sub-para f, page 33). I think this is satisfactory.

5. On (d), the Region proposes that JNT (the national public utility tariff board) should have the authority to establish specific financial and operational performance indicators, as well as power sector tariffs. It might be noted, however, that it would have been desirable in principle to combine, within the Energy Board, the function of approving investment plans (which it will have) with the functions of performance monitoring of power utilities and tariff-setting (which JNT will have); in fact, tariff-setting, performance monitoring, and investment planning are all interdependent functions not only within the power sector, but within and across other energy subsectors such as coal, gas and petroleum. Thus the fragmentation of decision-making in the energy sector that has beset Colombia in the past will continue, though it will be reduced. The reason for the current proposal is that, should Congress fail to pass the bill creating the Energy Board the government still can simulate it by decree. It cannot, however, create by decree a broader role for the Energy Board equivalent. The proposed FY89 energy sector loan should address the issue and aim to complete the process of integration.

6. I finally turn to the question of whether this should be an adjustment loan. It addresses institutional, investment and tariff issues like other sector investment loans in the power sector, and indeed it was processed as such. Unlike the Bangladesh energy sector adjustment loan the focus of this loan is quite narrow. However, compared to the Brazil power sector investment loans, this has more policy content. The creation of the Energy Board will enable it to cross the sectoral boundary but that initiative, as noted above, is a limited one. We cannot really say that a basic solution to the fragmentation problem will be obtained. Moreover, neither the Energy Board nor JNT will deal with tariff issues in coal, gas and oil. Those tariffs critically affect the performance of the power sector. A case in point is that no actions are proposed in this loan to increase the supply of LPG to poor consumers to offset the proposed power tariff increases. The case for treating it as an adjustment loan is marginal.

7. There is also a disbursement question. Initially, almost half of the disbursements were to be against interest during construction on our past loans. The Region decided this was not a suitable mechanism, and hence it is now proposing disbursements against general imports, subject to a negative list. It may be more desirable to finance a time slice of an approved public sector investment program as was done in the Pakistan energy sector adjustment operation. I understand that this is not being considered because the intention is to reserve project components for other donors. This issue might deserve further considerations.

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: August 3, 1987

TO: Operations Committee

V. Dubey

FROM: Vinod Dubey, Director, EAS

EXT: 78051

SUBJECT: World Bank Technical Assistance Activites and Issues (FY1982-86)

The World Bank Technical Assistance Activities and Issues paper will be discussed an an Operations Committee meeting on Wednesday, August 12 at 12 noon in Room E-1208.

The covering memo from Mr. Ducksoo Lee and the summary of the paper, distributed by Mr. Lee's office on July 27, provide an adequate agenda for the discussion.

cc: Mr. Shakow
Mr. Holsen
Mr. D.C. Rao
Mr. Baneth
Mr. Lee
Mr. Raphaeli
Mr. Bock

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

22853
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cc TBando

DATE: July 27 1987

TO: Distribution

FROM: Ducksoo Lee, CODDR

EXTENSION: 73348

SUBJECT: World Bank Technical Assistance Activities and Issues FY 1982-86: Report to the Board

The attached report was prepared at the request of the Board and is scheduled to be discussed on October 13. It explains the facts behind the figures which are submitted to the Board in the Annual TA Report (also attached for your reference) and highlights a number of central issues in technical assistance (TA), particularly as they relate to Sub-Saharan African countries. The report was prepared in OPS before the reorganization but has since been reviewed by COD and by the Regional Senior Operational Advisers whose comments are reflected in the report.

The report draws a distinction between two different types of TA in which the Bank is involved. The first is sometimes referred to as "engineering" or "hard" TA, and consists of engineering and architectural services relating to civil works and other hardware investments. These services are considered integral to the investments to which they are related and are generally appreciated by borrowers. The second type of TA is often called "institutional" TA or "soft" TA, and includes assistance for training, management, and the implementation of policy and institutional changes. Because institutional TA deals with problems that are difficult to define and resolve and that require thorough understanding of the social, cultural and institutional context, it has generally been less successful than engineering TA, and less acceptable to borrowers. There is also a problem with the definition and reporting of TA. Some "engineering" TA, as recorded by the Bank, may not be TA, properly speaking. If a country relies on local consultants for major engineering works this is a case of the public sector buying services from the private sector: there is no "assistance" involved. If one accepts this premise, the absolute figures for TA as a whole are lower, and the ratio of "soft" to "hard" TA is higher, than is commonly reported in Bank reports, including this one. We intend to advise the Board that guidelines will be issued to the staff on how to classify TA in SARs, which provide the data on which the Annual TA Report to the Board is based. ?

Subject to the endorsement of the Senior Vice President, Operations, the report will make the following recommendations:

1. Improve donor coordination of TA by seeking donor support for national technical assistance policies and by placing donor coordination of TA as an item on the agenda of consultative groups as appropriate.

2. Improve national management of TA by incorporating into future public sector management work, as a ~~high~~ priority, the objective of strengthening the ability of governments to plan and use TA effectively.

3. Encourage the development and use of local capacity, including local consulting services, to broaden the latter's experience and reduce the cost of TA.

This report will be on the agenda of the Operations Committee on Wednesday, August 12, 1987, at 12:00 p.m., room E1208.

Distribution:
Senior Vice President, Operations
Regional Vice Presidents
Vice President and General Counsel
Vice President, Sector Policy and Research (PPR)
Vice President, Financial Policy and Risk Management

cc: Messrs. Hopper (SVPPR)
Stern (SVPF1)
Wapenhans (SVPAD)
Baneth (IECDR)
Holsen (CECDR)
Rao (FRS)
Shakow (SPRDR)

For information: Messrs. Parmar (CIOVP)
Bock (DFS)

NRaphaeli:ngl
CODOP:2.13:ta

WORLD BANK TECHNICAL ASSISTANCE

ACTIVITIES AND ISSUES

(FY1982-86)

Nimrod Raphaeli
Central Operations Department
July 1987

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EXECUTIVE SUMMARY

Over the past several years, technical assistance (TA) has been a major concern within the development community. While much of the discussion is critical of TA, some positive results have ensued. The increased focus on TA, and the frustrations and disappointments which have come to light, have encouraged borrowers to be more vocal and involved in the TA process.

Technical assistance involves activities undertaken to promote economic and social development by enhancing human and institutional capabilities through the adaptation, mobilization, transfer and utilization of skills and technology. Successful TA is demand driven: the most effective users of TA are those who view it as a valuable (if expensive) resource to be actively exploited.

The World Bank finances approximately $1.3 billion in TA a year. About 90 percent of this assistance is financed through the lending program as project components. Much of the remainder is routine work financed through the administrative budget, including economic and sector studies and the preparation and supervision of projects. The Bank also administers more than $60 million a year in TA financed by others.

Conceptually, there are two fundamentally different types of TA in which the Bank is involved. The first is sometimes called "engineering" or "hard" TA, and consists of engineering and architectural services relating to civil works and other hardware investments. These services are considered integral to the investments to which they are related and thus transferable worldwide without extensive additional research. The second type of TA is often called "institutional" TA or "soft" TA, and includes assistance for training, management, and the implementation of policy and institutional changes. Because institutional TA deals with problems that are difficult to define and resolve and that require thorough understanding of the social, cultural and institutional context, it has generally been less successful than engineering TA. In addition, the outputs of institutional TA lack the precision of engineering solutions and are difficult to assess -- there is usually no "without project" situation against which to measure the impact of the TA. On the other hand, some "engineering " TA, as recorded by the Bank, may not be TA, properly speaking. If a country relies on local consultants for major engineering works this is a case of the public sector buying services from the private sector: there is no "assistance" involved. If one accepts this premise, the absolute figures for TA as a whole are lower, and the ratio of "soft" to "hard" TA is higher, than is commonly reported in Bank reports, including this one.

Difficulties are experienced with TA at both the national or macro-management level, and at the project or micro-management level. At the macro-management level, countries, particularly those in Sub-Saharan Africa, have problems managing and administering the large volumes of TA streaming into their countries. Administrative systems weakened by economic crisis and poor management are extended beyond their limits by the need to provide staff and logistical services to a large group of expatriates. Even free TA has a cost to the recipient in staff and facilities, which is often overlooked. In addition, the lack of effective mechanisms for tracking, coordinating, and monitoring TA, and the conflicting rules and procedures required by donors, often result in duplication of effort and limit the impact of TA.

At the project or micro-management level, the identification, design, and management of TA -- especially for institutional TA -- are often inadequate or inappropriate. Too frequently, TA reflects only the donor's or lender's conception of what is needed. Designed without a rigorous assessment of the borrowers's needs or careful specification of the work to be done and of how it will be done, TA often fails to elicit the borrower's commitment.

High cost of TA has also become a serious problem. It represents a political liability and economic burden to many borrowers. While high cost of TA is rooted in the salary levels of industrialized countries which provide most of the TA and most of the consultants as well, there is also an intangible, if very serious, factor which raises the cost of TA. Tasks are made to look more complex than they need to be, and terms of reference prescribe unduly elaborate credentials for experts which promote high-cost experts. High cost invariably cause delays because of prolonged discussion with borrowers over contracts.

To increase the effectiveness of TA, the Bank has already implemented some changes: it has created new lending instruments, conducted special studies of TA, and organized EDI seminars and Bank staff training courses. To further TA performance the Bank will undertake the following actions:

1. Improve donor coordination of TA by seeking donor support for national technical assistance policies and by placing donor coordination of TA as an item on the agenda of consultative groups as appropriate.

2. Improve national management of TA by incorporating into future public sector management work, as a high priority, the objective of strengthening the ability of governments to plan and use TA effectively.

3. Encourage the development and use of local capacity, including local consulting services, to broaden the latter's experience and reduce the cost of TA.

Implicit in these actions is the continuing need for working closely with borrowers on all aspects of technical assistance. Only by doing so can the Bank help identify the reasons for the poor management of technical assistance and convey to borrowers its eagerness to work with them in improving the effectiveness of TA. While not comprehensive, these actions can nevertheless go far in addressing the many problems associated with TA -- especially problems in the design, management, and cost of institutional TA.

While the report reflects Bank-wide experience, it has a strong focus on Africa where technical assistance difficulties are most common.

DRAFT
NRaphaeli:ngl
July 14, 1987

WORLD BANK TECHNICAL ASSISTANCE ACTIVITIES AND ISSUES (FY1982-86)

I. INTRODUCTION

1.01 An Annual Technical Assistance Report, containing statistical information on this activity, has been submitted to the Board since 1964. The purpose of this report is to inform the Board about the current status of the Bank's portfolio of technical assistance (TA) activities. The report attempts to: (i) identify the TA financed and administered by the Bank; (ii) raise a number of issues related to the effectiveness of TA, focussing in particular on Sub-Saharan Africa; and (iii) inform about actions that management has already taken and proposes to take to improve the effectiveness of TA.

1.02 TA covers activities that enhance human and institutional capabilities through the transfer, adaptation and utilization of skills and technology. These activities include: (a) pre-feasibility and feasibility studies, and engineering design and construction oversight for capital projects; (b) research on development problems; (c) institutional development; (d) policy related studies; (e) fellowships; (f) individual expert services to perform staff or line functions; and (g) training, short-term (seminars, study and observation tours, equipment familiarization) and long-term (study programs).

1.03 The central element of TA is the transfer of knowledge and experience. Technical assistance could have a short-term objective, which would be the importing of technical capacity to perform a particular function over a limited period of time, or a long-term objective, which would be to increase the capacity and effectiveness of individuals or institutions to perform a variety of functions. In the short-term TA agents can work with local agents or institutions to supplement their skills, without attempting to increase their capacity. The long-term objective requires action by the TA agents to enhance the skills and capacity of the local individuals and institutions.

1.04 Technical assistance is usually classified into two broad types of services: (i) engineering-related TA ("hard" TA), including items such as feasibility studies, engineering design, and assistance for the implementation of the physical aspects of projects, and (ii) institution-oriented TA ("soft" TA), including assistance for institutional development through improved organization, management and training, and policy advice at the macroeconomic, sectoral and sub-sectoral levels.

However, TA is a multidimensional activity, which is difficult to place into rigid categories, and the distinction between "hard" and "soft" is not meant to suggest inherently good or bad properties in the one or the other. Engineering TA could have a short term perspective, importing expertise to complete a particular job - the installation of a power generator - or it could have a long-term one - training local staff to undertake future installations without the help of outside experts.

1.05 The concept of TA is also ambiguous because it often includes not only the importation of expertise but also the hiring of local consultants and experts. For example, most of the consultants financed through Bank projects in LAC and, to a lesser degree in Asia are local, in which case what is involved is the provision of skills by the private to the public sector in the same country, rather than the recruitment of expatriate expertise.

1.06 Technical assistance has always been important in the Bank's operations 1/ as a complement to financing of investments because of the skill gaps prevalent among many of the borrowers. Its range has broadened in support of the diversification of the Bank's lending portfolio, the intensification of its institutional development efforts, and the requirements of its adjustment lending.

Funding, Categories and Distribution of TA

1.07 In terms of funding, TA activities fall into three categories; (a) Bank-financed TA which includes TA components in investment projects, freestanding TA loans, i.e., loans which are entirely for TA, the Project Preparation Facility (PPF) and the Special Project Preparation Facility (SPPF); (b) TA financed from the administrative budget, including Country Economic and Sector Work (CESW), project preparation and supervision, the Economic Development Institute (EDI), TA provided as part of the Cooperative programs with FAO and UNESCO, the special program of TA for IDA Countries and other forms of ad hoc TA diffused across various departments (e.g. debt management); and (c) TA administered but not financed by the Bank, as when the Bank serves as executing agency for UNDP. Category (a) is the most significant, averaging close to $1.3 billion per year, or 8.7 percent of total lending during FY82-86 (Table I-1). The TA implied in EDI's training work and in part of the staff activities related to economic, sector and project work, is usually not perceived as TA although it has had a profound influence on borrower's policy and institutional framework and on specific investment programs. These TA activities have never been quantified.2/

1.08 In the two Africa Regions, TA has averaged close to 35% of lending in FY82-86 (Table I-2), reflecting the needs of a continent with fragile institutions and inadequate supply of technical and managerial

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1/ Bank covers IDA and loans cover credits. All years in this report are fiscal years, except for UNDP which follows a calendar year cycle.

2/ Annex I provides a detailed discussion of the kinds of TA in which the Bank engages.

I.1

WORLD BANK TECHNICAL ASSISTANCE, FISCAL YEARS 1982-86
(in US$ million)

	FY82	FY83	FY84	FY85	FY86	FY82-86	% of Subtotal	% of Total
A. PROJECT-FINANCED TECHNICAL ASSISTANCE								
Project component of loans/credits	1,150.8	1,275.3	1,093.1	1,148.4	1,126.1	5,793.7	89.56	85.63
Free Standing loans/credits	72.5	52.7	135.0	109.7	137.9	507.8	7.85	7.50
Project Preparation Facility (PPF) *	31.3	33.9	32.3	28.1	35.7	161.3	2.49	2.38
Special PPF **	n.a.	n.a.	n.a.	2.9	3.4	6.3	0.10	0.09
Subtotal	1,254.6	1,361.9	1,260.4	1,289.1	1,303.1	6,469.1	100.00	95.61
B. TECHNICAL ASSISTANCE FINANCED THROUGH THE ADMINISTRATIVE BUDGET								
75% contribution to FAO, UNESCO, WHO, and UNIDO Cooperative Program (70%) ***	7.2	6.8	6.2	6.3	6.7	33.2	30.74	0.49
Tech. Assistance Program for IDA Countries	n.a.	n.a.	1.4	2.6	3.2	7.2	6.67	0.11
Economic Development Institute	10.4	12.3	13.9	15.1	15.9	67.6	62.59	1.00
Subtotal	17.6	19.1	21.5	24.0	25.8	108.0	100.00	1.60
C. BANK-ADMINISTERED TECHNICAL ASSISTANCE FINANCED BY OTHERS								
As executing agency for United Nations Development Programme	27.9	23.9	7.4	15.5	51.0	125.7 a/	66.40	1.86
Reimbursable assistance to capital-surplus countries	5.9	5.0	6.5	8.7	6.7	32.8	17.33	0.48
Other reimbursable assistance (including International Fund for Agricultural Development Program)	5.3	6.2	6.6	5.4	4.5	28.0	14.79	0.41
Consultant Trust Funds	n.a.	n.a.	n.a.	2.3	0.5	2.8	1.48	0.04
Subtotal	39.1	35.1	20.5	31.9	62.7	189.3	100.00	2.80
TOTAL	1,311.3	1,416.1	1,302.4	1,345.0	1,391.6	6,766.3		100.00

n.a. = not applicable

* There is double counting since PPFs are repaid or subsequently refinanced under loans/credits.

** Experience indicates that most SPPFs are converted into grants.

*** Contribution to WHO was terminated in FY84; the agreement with UNIDO will be terminated in FY87.

a/ The fiscal year of UNDP runs from January 1 to December 31.
UNDP figures refer to this time period.

Table I.2
WORLD BANK TECHNICAL ASSISTANCE
FISCAL YEARS 1982-86
(US$ million)

Region	FY82					FY83				
	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending	Total as % of Total Lending	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending	Total as % of Total Lending
Eastern and Southern Africa	92.8	30.7	123.5	714.6	17.3	170.7	6.0	176.7	1,129.8	15.6
Western Africa	179.9	26.0	205.9	1,086.9	18.9	138.4	26.0	164.4	664.2	24.8
East Asia and Pacific	370.4	0.0	370.4	2,723.4	13.6	484.1	0.0	484.1	3,708.6	13.1
South Asia	104.9	7.0	111.9	3,124.0	3.6	185.7	6.0	191.7	2,979.2	6.4
Europe, Middle East, and North Africa	138.7	0.0	138.7	2,379.1	5.8	137.0	4.5	141.5	2,535.6	5.6
Latin America and the Caribbean	264.0	8.8	272.8	2,987.9	9.1	159.5	10.2	169.7	3,459.6	4.9
Total	1,150.8	72.5	1,223.3	13,015.9	9.4	1,275.3	52.7	1,328.0	14,477.0	9.2

Region	FY84					FY85				
	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending	Total as % of Total Lending	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending	Total as % of Total Lending
Eastern and Southern Africa	222.0	26.6	248.6	1,186.6	20.9	131.5	27.8	159.3	786.0	20.3
Western Africa	138.3	53.9	192.2	1,181.7	16.3	134.0	47.7	181.7	811.3	22.4
East Asia and Pacific	295.4	10.0	305.4	3,302.0	9.2	486.4	0.0	486.4	3,100.6	15.7
South Asia	155.9	35.0	190.9	3,700.6	5.2	102.5	0.0	102.5	3,559.1	2.9
Europe, Middle East, and North Africa	148.1	0.0	148.1	3,125.8	4.7	124.3	4.7	129.0	2,429.2	5.3
Latin America and the Caribbean	133.5	9.5	143.0	3,025.6	4.7	169.6	29.5	199.1	3,698.2	5.4
Total	1,093.2	135.0	1,228.2	15,522.3	7.9	1,148.4	109.7	1,258.1	14,384.4	8.7

Region	FY86					FY82-86				
	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending a/	Total as % of Total Lending	(1) TA Component Amounts in Ln/Cr.	(2) Free-Standing Amounts	(1) + (2) Total	Total Lending	Total as % of Total Lending
Eastern and Southern Africa	117.3	53.4	170.7	1,254.7	13.6	734.3	144.5	878.8	5,071.7	17.3
Western Africa	138.8	5.0	143.8	1,327.2	10.8	729.4	158.6	888.0	5,071.3	17.5
East Asia and Pacific	383.4	20.0	403.4	3,565.2	11.3	2,019.7	30.0	2,049.7	16,399.8	12.5
South Asia	117.3	0.0	117.3	3,631.0	3.2	666.4	48.0	714.4	16,993.9	4.2
Europe, Middle East, and North Africa	115.4	12.0	127.4	2,304.8	5.5	663.5	21.2	684.7	12,774.5	5.4
Latin America and the Caribbean	253.9	47.5	301.4	4,771.2	6.3	980.5	105.5	1,086.0	17,942.5	6.1
Total	1,126.1	137.9	1,264.0	16,854.1	7.5	5,793.8	507.8	6,301.6	74,253.7	8.5

a/ Includes $535.4 million in African Facility Credits skills. However, there has been a relatively sharp decline in the TA share of lending in Africa in FY86 (24.4%) compared with previous years. This can be attributed to the establishment of the Special Facility for Sub-Saharan Africa (the African Facility) in FY86. Funds from the Facility are utilized to help IDA-eligible Sub-Saharan African countries to strengthen their programs of policy reform through structural and sectoral adjustment, and rehabilitation and emergency reconstruction projects. Due to the nature of these quick-disbursing credits, TA components are not common. Therefore, the inclusion of $535.4 million of the African Facility Credit (see footnote Table 1.2) in total FY86 lending figures may have contributed to lowering the FY86 TA share of lending in Africa compared to previous years. In the South Asia, EMENA and LAC Regions, TA averages about 5% of total lending. This relatively low proportion is attributed to the lack of demand for TA of the major borrowers in three Regions -- India, Turkey, Brazil and Mexico, and to the availability of considerably advanced local consultancy capacity. In East Asia and Pacific, 12.5% of the lending goes to TA due largely to a willingness to borrow for this purpose by Indonesia (hitherto the Region's largest borrower), and the importance of the policy-related TA in the countries of the Region.

1.09 In earlier years the financing of TA went principally to engineering services for project design and construction, but in recent years it has included a high proportion of preinvestment studies, expert services for project preparation and implementation, institutional development, and project-related training. While Bankwide, TA for FY82-86 is divided into 45.7% hard TA and 54.3% soft TA (Tables I-3 and I-4) there is a perceptible shift from "hard" to "soft" already noticed by the 1983 Project Implementation and Supervision Report. This shift appears to have accelerated in FY86 with the exception of LAC, where TA is divided almost evenly between hard and soft; in the rest of the Bank almost two thirds of all TA was soft. Since soft TA is more difficult than hard TA in terms of design, implementation and supervision the implications on staff time are significant.

Table I.3
TECHNICAL ASSISTANCE COMPONENTS IN WORLD BANK LOANS AND CREDITS, FISCAL YEARS 1982-1986
by Region and Sector
(US$ thousand)

	Eastern and S. Africa			Western Africa			East Asia and Pacific			South Asia			Europe, Middle East and North Africa			Latin America and the Caribbean			ALL REGIONS		
	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total
Agriculture and Rural Development	28,768	155,791	184,559	35,000	116,780	151,780	298,673	180,838	479,511	59,850	101,008	160,858	60,155	73,340	133,495	123,438	150,122	273,560	605,884	777,879	1,383,763
Education	11,321	23,601	34,922	8,645	45,220	53,865	38,028	509,667	547,695	7,512	17,078	24,590	12,928	81,693.	94,621	10,408	49,894	60,302	88,842	727,153	815,995
Energy	39,568	15,778	55,346	50,319	40,269	90,588	119,600	36,650	156,250	120,890	4,700	125,590	55,514	20,846	76,360	41,070	21,135	62,205	426,961	139,378	566,339
Industrial Development and Finance	4,880	11,390	16,270	2,946	18,130	21,075	14,120	45,985	60,105	2,155	32,805	34,960	3,746	21,095	24,840	4,734	23,391	28,125	32,579	152,796	185,375
Industry	14,215	36,085	50,300	14,105	16,900	31,005	38,546	111,015	149,560	105,435	21,105	126,540	56,650	33,385	90,035	3,300	16,390	19,690	232,250	234,880	467,130
Nonproject	950	4,750	5,700	1,790	7,180	8,970	0	0	0	1,780	105	1,885	0	0	0	8,230	4,770	13,000	12,750	16,805	29,555
Population, Health and Nutrition	2,190	8,260	10,450	4,990	31,415	36,405	9,955	60,575	70,530	1,520	5,240	6,760	2,415	6,000	8,415	8,570	29,218	37,788	29,640	140,708	170,348
Power	84,985	50,780	135,765	35,155	31,180	66,335	159,350	24,176	183,526	49,650	16,570	66,220	39,334	33,880	73,214	74,362	52,554	126,916	442,836	209,140	651,976
Telecommunications	450	10,950	11,400	2,557	10,578	13,135	1,800	4,635	6,435	220	2,585	2,805	0	3,280	3,280	0	1,000	1,000	5,027	33,028	38,055
Transportation	49,270	113,100	162,370	66,018	74,252	140,270	157,626	92,274	249,900	31,610	27,825	59,435	24,355	27,430	51,785	81,021	41,472	122,493	409,900	376,353	786,253
Urban Development	7,420	13,550	20,970	25,557	35,814	61,371	36,254	19,851	56,105	14,730	23,975	38,705	13,895	26,662	40,557	57,835	95,735	153,570	155,691	215,587	371,278
Water Supply and Sewerage	32,181	14,051	46,232	30,379	24,261	54,640	36,024	24,020	60,044	8,380	9,625	18,005	50,210	16,685	66,895	49,820	32,070	81,890	206,994	120,712	327,706
Total	276,198	458,086	734,284	277,460	451,979	729,439	909,975	1,109,686	2,019,661	403,732	262,621	666,353	319,201	344,296	663,497	462,788	517,751	980,539	2,649,354	3,144,419	5,793,773
Hard/Soft TA as a percentage of region total	37.6	62.4	100.0	38.0	62.0	100.0	45.1	54.9	100.0	60.6	39.4	100.0	48.1	51.9	100.0	47.2	52.8	100.0	45.7	54.3	100.0

Table I.4
TECHNICAL ASSISTANCE COMPONENTS IN WORLD BANK LOANS AND CREDITS, FISCAL YEARS 1982-1986
by Region and Sector
(Percentage)

	Eastern and S. Africa			Western Africa			East Asia and Pacific			South Asia			Europe, Middle East and North Africa			Latin America and the Caribbean			ALL REGIONS		
	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total
Agriculture and Rural Development	10.4	34.0	25.1	12.6	25.8	20.8	32.8	16.3	23.7	14.8	38.5	24.1	18.8	21.3	20.1	26.7	29.0	27.9	22.9	24.7	23.9
Education	4.1	5.2	4.8	3.1	10.0	7.4	4.2	45.9	27.1	1.9	6.5	3.7	4.1	23.7	14.3	2.2	9.6	6.1	3.4	23.1	14.1
Energy	14.3	3.4	7.5	18.1	8.9	12.4	13.1	3.3	7.7	29.9	1.8	18.8	17.4	6.1	11.5	8.9	4.1	6.3	16.1	4.4	9.8
Industrial Development and Finance	1.8	2.5	2.2	1.1	4.0	2.9	1.6	4.1	3.0	0.5	12.5	5.2	1.2	6.1	3.7	1.0	4.5	2.9	1.2	4.9	3.2
Industry	5.1	7.9	6.9	5.1	3.7	4.3	4.2	10.0	7.4	26.1	8.0	19.0	17.7	9.7	13.6	0.7	3.2	2.0	8.8	7.5	8.1
Nonproject	0.3	1.0	0.8	0.6	1.6	1.2	0.0	0.0	0.0	0.4	0.0	0.3	0.0	0.0	0.0	1.8	0.9	1.3	0.5	0.5	0.5
Population, Health and Nutrition	0.8	1.8	1.4	1.8	7.0	5.0	1.1	5.5	3.5	0.4	2.0	1.0	0.8	1.7	1.3	1.9	5.6	3.9	1.1	4.5	2.9
Power	30.8	11.1	18.5	12.7	6.9	9.1	17.5	2.2	9.1	12.3	6.3	9.9	12.3	9.8	11.0	16.1	10.2	12.9	16.7	6.7	11.3
Telecommunications	0.2	2.4	1.6	0.9	2.3	1.8	0.2	0.4	0.3	0.1	1.0	0.4	0.0	1.0	0.5	0.0	0.2	0.1	0.2	1.1	0.7
Transportation	17.8	24.7	22.1	23.8	16.4	19.2	17.3	8.3	12.4	7.8	10.6	8.9	7.6	8.0	7.8	17.5	8.0	12.5	15.5	12.0	13.6
Urban Development	2.7	3.0	2.9	9.2	7.9	8.4	4.0	1.8	2.8	3.6	9.1	5.8	4.4	7.7	6.1	12.5	18.5	15.7	5.9	6.9	6.4
Water Supply and Sewerage	11.7	3.1	6.3	10.9	5.4	7.5	4.0	2.2	3.0	2.1	3.7	2.7	15.7	4.8	10.1	10.8	6.2	8.4	7.8	3.8	5.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Hard/Soft TA as a percentage of region total	37.6	62.4	100.0	38.0	62.0	100.0	45.1	54.9	100.0	60.6	39.4	100.0	48.1	51.9	100.0	47.2	52.8	100.0	45.7	54.3	100.0

II. ISSUES IN TECHNICAL ASSISTANCE

2.01 This section highlights a number of issues concerning the effectiveness of TA, focussing on those that are particularly relevant to Sub-Saharan Africa. These issues refer, first, to the actual concept of TA, which is an ambiguous one and conditions most of the analysis of the subject; second, the special difficulties experienced by soft TA, which constitutes the largest proportion of the assistance received by Sub-Saharan Africa; third, the importance of country commitment to the TA programs, a crucial factor determining the success of soft TA; fourth, the consequences of the high cost of TA activities; and finally, the problem of excessive supply of TA to Sub-Saharan African countries and its consequences.

A. The Concept of Technical Assistance

2.02 The Technical Assistance Annual Report has classified TA into four categories: (a) Engineering/Implementation/Construction Supervision; (b) Technical/Feasibility Studies; (c) Training; and (d) Experts/Consultants. The first two categories are treated as hard TA and the last two as soft. However, there are two important conceptual issues behind the classification.

2.03 The first has to do with what really constitutes TA to developing countries, with all the economic, social and political connotations that the term implies. At present, all imports of technical expertise included in the categories listed in para. 2.02 and supported by loans/grants are considered TA. However, this implicitly assumes that the recipient country is deficient in all the skills and knowledge being imported, and that it needs and intends to build up its capacity in those areas as soon as possible. This, of course, is often not true. Each country, at any point on its development path, will plan to build up its local capacity in only a proportion (probably large) of the skills and knowledge that it lacks, but would probably not attempt to become fully self-sufficient in this regard. For example, while a country might need a new dam, there is no reason why it should have the capacity to design a dam by itself, if the scope for such an activity is limited or the skills are needed infrequently. In an age of high technological specialization, it will be normal for all countries of the world to import technical skills and such imports will not be limited to one category of countries. Indeed, industrialized countries are the biggest importers as well as exporters of technology and know-how.

2.04 The current concept of TA, by implying that all activities in this area cover a gap which should eventually be filled, assumes total import substitution, which is plainly impractical. Most probably, a sizable proportion of the hard TA, and perhaps a small proportion of the soft TA, reflect skills which the countries would have imported in any case. This is not "assistance." As countries become stronger institutionally, the need for soft TA is likely to decline, but imports of hard technologies might increase.

2.05 Thus, the figures provided in past Bank (and other agencies') reports overestimate the TA received by the countries to actually supplement skills or fill skill gaps. Since the overestimation (which cannot be quantified) is probably larger for hard TA, it means that the proportion of soft TA out of the total "real" TA is much higher.

2.06 The second issue is the inclusion of the financing of local consultants and experts in the totals for TA. These funds do not assist in importing skills, but serve simply as a means of obtaining, usually for the public sector, skills already available in the country. This is particularly important for many of the institutionally advanced countries in Asia and LAC, in which most of the Bank-financed soft TA (e.g., public sector management operations) go to the financing of local consultants. A rough calculation suggests that the overestimation of the total TA figures on this account may be 25%. Thus, if these two categories were to be properly estimated and added, it would become apparent that in many instances countries are not purchasing TA from outside but simply employing national consultants to provide certain skills in the same manner that an industrialized country might employ a private research center to do a study. Management will issue guidelines to the staff on the classification and reporting of TA components in Bank projects.

B. "Hard" and "Soft" Technical Assistance

2.07 The difference between hard and soft TA is an important one from an operational viewpoint. Past records, confirmed also by OED's findings, indicate that in general, hard TA is better designed and implemented, and has had a more positive impact than soft TA. This conclusion is important, because the amount of soft TA is growing, especially in relation to structural and sectoral adjustment operations, and particularly in SSA.

2.08 These conclusions do not mean, of course, that hard TA has been without problems but, overall, it has achieved its objectives. A number of examples will illustrate the point. The Bank financed engineering studies for a dry dock project in Senegal and consultancy service in transport planning, engineering and design for a final assessment of the viability of a pulp mill project in Malawi. In both instances, the TA project resulted in dissuading the Government from launching ventures that would have had serious adverse financial and economic consequences for the country.[3/] An even more significant case is the Lubuge Hydroelectric Power Station in China. The Chinese Government has prepared an interesting paper which highlights the excellent performance of the consultant(s) in each major component of the project, their recommendations and the resulting cost savings.

2.09 Conversely, there is considerable evidence that, with a few notable exceptions, soft TA has generally been less successful than hard TA. For example, a case study of eleven highway projects in Zambia notes that most of the feasibility and preliminary engineering studies proceeded smoothly and were followed by the implementation of the physical facilities, whereas most of the management, organization and financial

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3/ OED, Tenth Annual Review of Project Performance Audit Results (in Three Volumes), Volume II: Sector Reviews, August 1984, para. 6.01.

studies suffered delays. Moreover, the recommendations concerning the latter were not readily adopted by the Government.[4/]

2.10 A study of the Bank-assisted irrigation sector in Indonesia arrived at a similar conclusion, in which the contrast between the hard and the soft TA appeared clearly along the lines discussed here.[5/] Finally, a recent evaluation of the TA portfolio in EMENA, undertaken in connection with the 1986 PIR, concluded that more than half of all TA studies, both engineering and institutional, were delayed by at least six months, although institutional studies experienced far greater delays, and accounted for 90 percent of all study start-up delays.

2.11 There are several reasons for the divergent results of hard and soft TA. Hard TA has been more successful because: (a) countries perceive TA as an integral part of investment projects; they are committed to it and are willing to pay; and (b) the tasks are specific and can be defined quite precisely; the borrower is usually involved in some aspects of project preparation, and the outcome of the investment is visible and often a source of national pride. The above features do not characterize much of the soft TA. The objectives of the TA and methods for achieving them cannot be defined with the same precision, and benchmarks for measuring progress are difficult to prescribe. Hard TA can generally proceed on the basis of a blueprint, while soft TA often involves a process of "learning by doing."

2.12 There are other reasons why soft TA tends to have an uncertain outcome: (a) in many cases, the need for soft TA is recognized late in the project cycle, often during appraisal. Therefore, there is insufficient time either for Bank staff or borrowers to consider its scope, alternative designs, cost estimates, organization, etc.; (b) often Bank staff do not take adequate steps to ensure that their perceptions regarding the need for TA are also shared by the borrower. In this event, the latter accepts the TA as an unavoidable "add on" to the main project, but may not be seriously committed to it; (c) when the objectives, scope and design of TA are not well-articulated, it is difficult to select the right consultants, prepare clear terms of reference or give effective guidance to the consultants; and (d) often not enough attention is given to TA implementation during supervision missions, especially where the TA is not linked directly to the physical implementation of the project, or is peripheral to the central objective of the project.

2.13 The difference in outcome between hard and soft TA can also be explained in terms of the institutional arrangements for utilizing it. For example, hard TA intended to enhance the performance of a power agency (or others such as telecommunications or industry) may be utilized efficiently because the entity already has a built-in technical and administrative capacity, a mandate to pursue a well-defined work program, and an assurance

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4/ "Review of Bank-financed Technical Assistance in Zambia," EAP, January 18, 1984.

5/ "Indonesia: Bank-financed Technical Assistance and the Irrigation Sector," AEP, October 5, 1984. See also Annex III.

of non-interference in its day-to-day technical operations. However, soft TA aimed at improving a country's capacity to design and implement policies might cut across different agencies and hence be subject to internal jurisdictional problems and political sensitivity, and may be difficult to administer or to ensure proper accountability. Also, a large proportion of soft TA is directed at some of the weakest institutions in the social sectors, with very limited capacity to absorb it. These institutions have difficulties assigning counterparts and, when they do so, many counterparts are poorly trained and motivated; therefore, it often happens that experts perform operational tasks at the expense of their training function. There is a vicious circle implicit here: the weaker and less established institutions, which in general are more in need of TA, are the least able to make use of it.

C. Borrower's Commitment

2.14 Unlike physical investments which, when properly designed and contracted out, can be expected to proceed smoothly, soft TA in particular does not seem to generate its own momentum toward implementation. Its implementation depends on the strength of the commitment both of the recipient and the donor to the TA objectives and the mode of its delivery. Commitment by the recipient is particularly crucial for soft TA because it strongly influences the attitude and actions which the recipient brings to bear on the implementation process. In the context of TA commitment means taking expeditious action on the selection of consultants; providing counterparts, local funding, access to decision makers when needed, backstopping (e.g., office space, secretaries, etc.); monitoring progress, and providing feedback aimed at improving efficiency; and willingness to act upon recommendations.

2.15 OED reveals a pattern of borrower reluctance to be fully committed to the objectives and procedures of TA in all Regions, but particularly in Sub-Saharan countries (see entries 1, 6, 15 and 16 in the bibliography). This attitude is particularly evident in TA programs which the borrowers were either pressured to accept without full consultation or which formed part of a larger program which they considered important and hence had no alternative but to accept. On the other hand, when the borrower is satisfied about the need for the TA, there is evidence that borrower cooperation has been very good, even in the face of a variety of administrative or other constraints.

2.16 There is a perception among many borrowers that the Bank plays a dominant role in the selection and design of TA components, and often in the identification and design of freestanding TA loans as well. There are, of course, instances where the borrower clearly identifies the TA needs and takes the initiative in seeking donor support for it. But more typically the borrower's role has tended to be a passive one.[6/] In most of the

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6/ The theme of governments being passive is repeated in the report of the West Africa TA Task Force, and in numerous OED studies. The passive role of government may reflect a lack of capacity to assess the need and perhaps an innate lack of commitment among those who are the intended beneficiaries.

cases reviewed, the need for TA was first identified by the Bank during project preparation or appraisal, and elaborated upon in the SARs. The SARs frequently provided draft TOR for consultants which, more often than not, were adopted by the relevant agency, either verbatim or with only minor modifications. Even when the agency drafts its own TOR, its commitment may be lessened if the Bank were to seek major changes.

2.17 There may be other reasons for inadequate borrower commitment: (i) inclination to underestimate the complexity of certain development undertakings and of their consequent managerial and technical skill requirements; (ii) belief that skilled manpower (particularly from abroad) is not needed, that the task can be accomplished by local personnel; (iii) aversion to politically sensitive studies; (iv) disinclination, especially in the event of economic reversals and strong indigenization pressures, to use borrowed funds for expatriate manpower; and (v) lack of experience with Bank procedures or poor administrative capacity.

2.18 To a larger extent, commitment becomes a function of involvement: if the borrower is involved in the design of technical assistance and is convinced of its usefulness, the chances of his commitment will be enhanced. In Jamaica, for example, a review by the Regional staff found that clients whose participation was judged most effective were those who identified the needs and formulated a plan for meeting these needs, and seized upon the Bank's TA loan as a resource for implementing their action plan. These clients had a sense of ownership in the TA and committed their organizations to its success.[7/]

2.19 Even where an agency is strongly committed to the TA, it may lack the capacity to get the most out of the consultants during their stay. Perhaps there is a logical inconsistency in expecting an agency which lacks basic skills or experience to be able to articulate TA needs, supervise and guide the activities of TA personnel, and critically review and utilize their output. A team of high powered consultants may not only be too much for a government agency to handle easily; it may also have an intimidating effect on local officials who are used to a slower pace and the lack of a challenging environment. On the other hand, the initial reluctance on the part of an agency does not necessarily mean that commitment will always be lacking and that the TA will be inevitably wasted, but that the build-up of support for TA may be slow and difficult.

2.20 The Bank has tried a number of approaches to enhance the borrower's commitment. First, the Bank examines the borrower's priorities for TA, and proposes TA projects, or TA components for which commitment is high, and avoids those where it is weak. Second, it uses its dialogue with the borrower to build or enhance the latter's commitment through education and persuasion. Third, it seeks to influence commitment through negotiating changes in the structures and processes of borrower organizations so that borrower actors who are committed have greater influence on events than those who are not.

7/ An Interim Review of World Bank's First Jamaican Technical Assistance Loan: Lessons Learned about Technical Assistance Effectiveness; LAC, April 30, 1986.

D. Cost of TA

2.21 The cost of services provided under technical assistance programs tends to be high particularly, but not exclusively, in the African context. Foreign consultants are presently budgeted by the Bank at about \$10,000-12,000 per man-month,8/ and an even higher amount in some special instances. Within this range there is a wide variation of cost patterns depending on the country and type of activity. For example, in the technical assistance credit to Rwanda (1669RW) the range was \$10,080-13,060 per man-month, and in the Malawi transportation sector it was \$7,500-10,000.9/ The exception to this cost pattern is the LAC Region where most consultants are "regional" and their cost has averaged \$5000-\$6500 per month.

2.22 When the Bank seconds its own staff to fill TA positions, the cost has averaged about \$14,500 per month in a typical three-year assignment. Also, through the end of 1986, the overall cost of fixed-term non-Bank staff seconded to Kenya or Indonesia under Bank auspices was \$96,000 and \$118,500 or 35% and 51% higher, respectively, than the cost of staff hired on UNDP terms. If regular Bank staff were seconded to either of these two countries, the overall cost would have been 80% and 93% higher respectively than the UNDP package. The issue is further discussed in the next section.

2.23 The high cost of TA represents a political and economic burden to many borrowers, particularly in Sub-Saharan Africa. The reasons for this cost pattern are high base salaries of expatriates from industrialized countries, the recent decline in the value of the dollar against major European currencies (which will be reflected in the cost pattern of future contracts), the high overheads and profit margins of reputable overseas consulting firms, and the need to offer an incentive which would compensate for the difficult working environment in many African countries. There is also an intangible factor which inflates the cost of consultants. Tasks are sometimes made to look more complex than they need to be, thereby promoting high cost consultants. It is therefore understandable that countries are becoming reluctant to borrow for TA and, when they do, they are as reluctant to hire overseas consultants. Even after negotiating loans for TA, borrowers continue as they should to explore alternative grant sources wherever they can find them. Recently, Madagascar and Djibouti obtained UNDP grant funds and Zambia obtained grant cofinancing from Ireland, in all cases to substitute for Bank credits.

8/ Another 20-40 percent is usually added if the consultant is provided by a firm.

9/ The Storrar's Report (1982) noted that Nigeria, which was the largest beneficiary of the APMU program, felt that salaries of Bank recruited staff were too high. The report notes that "Recently, new staff were offered salaries 20% lower than previously given and government has been able to find seemingly competent staff at that level." Since then, the Government of Nigeria has set up its own recruiting agency.

2.24 High cost is responsible for many delays. The Project Completion Report for the First and Second Technical Assistance Credits to Burundi (613BU and 917BU) attributed the delay in the selection of staff to "the sensitivity of the Ministry of Planning to the high cost of technical assistance by Burundi standards, resulting sometimes in protracted discussions over contract conditions." This same problem was identified in Bangladesh, where the cost of consultants was as much as 30 times the cost of their counterparts. "This differential," it was observed, "is a natural cause of resentment -- particularly when the unique skills of the TA personnel, or their higher productivity compared with local staff, may not always be manifest."[10/]

2.25 TA has also an indirect cost to the borrower, which is not easily measured. Consultants in general, and resident consultants in particular, need logistical support -- offices, counterparts, secretaries and other support staff not to mention high standard housing, all of which are already in short supply. In addition, the discussion, negotiation and coordination of TA imposes a high burden on the limited time and capacity of the few senior civil servants. Thus even grant TA has a high cost to the recipient, and while donors might view it only as a fraction of the value of TA rendered, governments are often unable to bear it, which results in subsequent underutilization of TA.

2.26 On the other hand, borrowers do not always object to high cost in hard TA where it is an integral part of a physical investment, or where qualified local staff are simply not available to undertake the tasks. In these cases, it is more clear that the cost of hiring foreign personnel may well be less than the real costs involved in not performing the tasks efficiently and on time.

E. Technical Assistance in Sub-Saharan Africa

2.27 In the countries south of the Sahara, it is widely recognized that the substantial financing devoted by donors to TA during the past two decades has helped to bring about some remarkable advances in several fields, such as education. At the micro level, too, the Bank's experience includes a good many cases of success, even in the soft TA. Documented success stories include the Kenya Tea Development Authority[11/] and the assistance given to Kenya to establish an oil pipeline company.[12/] The first TA credit to Tanzania succeeded in attaining its primary objectives:

10/ OED Operational Policy Review, Review of Bank Technical Assistance in Bangladesh, December 1982, para. 5.03.

11/ Geoffrey Lamb and Linda Muller, The Kenya Tea Development Authority, Staff Working Papers No. 550, 1982.

12/ OED, PPAR, "Mombassa-Nairobi Oil Products Pipeline," Report No. 3483, June 24, 1981.

strong pipeline of new investment projects resulted from some of the studies, and others made substantive recommendations on capacity utilization improvement and training.13/ In Mauritania, an expatriate team of advisers in the Ministry of Planning succeeded in building a core group of high level civil servants who are "actively promoting sound project evaluation techniques, and is trying to implement these techniques in the technical ministries."14/

2.28 However, there is also a feeling that much of the TA provided to African governments has not resulted in sustained improvements in institutional capacity. As Mr. Damiba, the UNDP's Assistant Administrator for Africa, puts it, the experience with TA in Africa "has been most successful as a way to fill gaps and perform productive and economic management tasks." The challenge, however, of "developing sustainable national capacity...has thus far proven largely elusive with critical and now tragic results..."15/ Indeed, many of the programs are no longer in place. Staff trained under the programs have often been shifted or have left. The objective of greater self-sufficiency in skill endowments is far from being achieved, and national capacities for economic management do not seem to have improved significantly in many African countries. The newly created capacity has often proved to be fragile, and collapsed when external aid was phased out.

2.29 The problems associated with TA at both the country (macro) and project (micro) level in Sub-Saharan Africa have been the subject of many studies by the Bank and other donors; for example, the OED reports, the Storrar's Report and the recent Task Force Report on TA in West Africa (see bibliography). At the macro-level the central issues of TA are (i) the burden placed on governments to receive and implement TA from a multiplicity of donors, often subject to different administrative arrangements, and (ii) the lack of a coordinated effort among donors to identify needs from a shared perspective. The former has resulted in overloading the already fragile administrative capacity of governments (system overload), while the latter has produced a bewildering array of programs not always supporting one another, and sometimes mutually conflicting.

2.30 System overload results when TA is mostly supply-driven, does not clearly reflect the priorities of the borrower, and is often beyond the latter's absorptive capacity. Supply-driven TA is the result of at least three factors: (a) donors have funds allocated to a country, which they prefer, for budgetary purposes, to utilize by a certain deadline; (b)

13/ PCR, Tanzania - First Technical Assistance Project (Credit 601-TA), March 1987.

14/ PCR, Mauritania, First TA Project (Credit 660-MAU), May 1985.

15/ Nordic Conference on Technical Assistance in Africa, Denmark, April 23, 1986.

donors and sometimes recipients, acting under pressure from consultants who are already on-the-job, to extend their contracts; and (c) tendency by donors to generate studies beyond the installed capacity or the real need of the recipient. These factors are sometimes coupled with borrower inertia and a sense of obligation to accept "free goods." According to the UNDP, Sub-Saharan Africa receives more than $3 billion 16/ in technical assistance a year, including $350 million of Bank loans for each of FY82-86. Other estimates, that include all forms of expatriate expertise, training, and supervision missions associated with capital assistance projects, suggest that the amount may exceed $4 billion a year. Typically, 25 to 35 percent of official development assistance (ODA) is devoted to technical assistance. UNDP estimates that the largest part of donor support for TA is for expatriate personnel -- estimated to be 75,000-100,000 people a year. A recent study of TA in West Africa indicated that the bulk of $200 million a year provided by the Bank for TA in the Region will be used to finance consultants. This suggests (assuming an average cost of $100,000 per consultant/year) that upwards of 1500 consultants will be working at any one time in West Africa under Bank-financed contracts; perhaps 200-300 of these will be residents, with the rest employed on short-term assignments.

2.31 System overload is further exacerbated by what the 1985 World Development Report described as an "inordinate proliferation of projects, straining the financial and manpower capacity of recipient countries to implement, monitor and maintain them." For example, Kenya in the early 1980s was trying to cope with 600 projects supported by 60 donors. UNDP has estimated that there were 188 projects and 50 donors in Malawi, 321 projects and 69 donors in Lesotho and 614 projects involving 69 donors in Zambia.

2.32 The case of Somalia dramatizes the issue of system overload. According to OECD figures, the total annual flow of official TA grants to Somalia rose rapidly after 1976; it doubled between 1976 and 1979 and quadrupled again by 1983 when it reached $120 million. Although total official development assistance from these sources also increased sharply, largely in the form of emergency assistance, TA grew faster and in 1983 accounted for over half of all grant disbursements and over one third of all ODA. Cumulative total TA grants over the five year period 1980-1984 are very likely to have been over a half billion dollars or well over $100 per capita.17/

2.33 Another case of overload is the Cameroon. An OED Report on the first Bank-assisted TA project points out that it was barely underway and

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16/ The estimates are based on an informed judgement rather than on firm information provided by all the donors concerned. Precise information is not available from all donors, particularly from the Eastern Bloc countries.

17/ Somalia, Report of a Joint Technical Cooperation Assessment Mission, 1985, para. 25.

the problems of implementation not yet clearly identified (and certainly not resolved), when there were already suggestions that available funds would be insufficient. In 1980, shortly before the first postponement of the Closing Date, a Project Brief was circulated for a second TA project. While the second project was not yet fully underway the Bank was already planning the preparation and appraisal of the third TA project. While the continuity of support for the objectives of TA programs was clearly necessary, the design of follow-on projects did not have the full benefit of the lessons from earlier projects.[18/]

2.34 The Bank's financing of TA is often influenced by its desire to ensure efficient implementation of Bank-assisted investment projects. While building the borrower's capacity to formulate policies and manage the development process are as important to the Bank as the creation of productive assets, there is sometimes a problem in striking a balance between these long- and short-term objectives, which has been highlighted by the Western Africa Region as follows:

> "...the lending program and project design do not sufficiently address the conflict between the need for quick results in the short-term and objectives of building up local capabilities in the long-term. The weaker the local capabilities, the more outside [TA] is deemed necessary for quick short-term results, but the heavy reliance on [TA] will inhibit the development of local capabilities. Recipient governments and agencies, while often protesting the need for so much [TA], want to keep the Bank happy and may find it convenient to have expatriates to do some of their work for them."

The Region observes that, as a result, "we often put together multipurpose projects that are difficult for the recipients to manage and for the Bank to supervise."

2.35 In reaching the conclusion noted above, the West Africa Region was highlighting the problem of project and program complexity. The report states that the fundamental objective of TA was capacity building. The challenge of designing TA is thus to select a package that borrower institutions can handle. Thus, project-related components -- consultants, resident advisers, studies, training -- must complement local capacity and be compatible with local procedures and practices. Local institutions could manage a carefully sequenced series of simple but well-defined capacity-building objectives, but may have difficulty in absorbing a comprehensive, multi-sectoral TA project. In practice, however, many TA programs have been overambitious in scope and unrealistic in their expectations.

18/ OED, PPAR, Cameroon: First Technical Assistance Project (Credit 673-CM), February 28, 1986, para. 68.

2.36 OED has also observed that sometimes the Bank has not paid sufficient attention to the capacity of institutions to absorb TA. An example is the First Tanzanian Tea Project, in which a highly ambitious planting target and the construction or expansion of five tea factories was to be undertaken by a newly-established agency which at appraisal had only four professional staff. In the Central African Republic, a highway project had to be scaled down three times, and eventually completed only 10-20 percent of its planned program, because both the financial resources and implementation capacity of the borrower had been greatly overestimated. In Burundi, excessive TA resulted in some duplication between experts. All these problems lead to the inevitable conclusion that if the client has too much TA to manage and to service, perhaps it would be necessary to go slower and simpler with TA, even at the cost of somewhat reduced transfer of resources.

2.37 TA Coordination. There is a widespread perception among African governments that planning and management of TA flows is not sufficiently coordinated, coherent or systematic.[19/] The root of the problem is in the programming process in donor countries for allocating TA resources to various recipients, which requires that, in part, the priorities are decided, specific activities identified and costed, and a time-frame developed to suit their budgetary process. However, from the point of view of small countries or those with thinly staffed administrations, the very process of receiving and allocating external aid is a major task. The country must cope with a large number of external agencies which follow differing procedures. Some specific problems in this regard are: (a) the donors' planning cycles may not coincide with the country's own planning cycle;[20/] (b) most bilateral donors have priorities of their own that limit the purposes for which their aid can be used; (c) the procedures, information and planning documentation requirements differ; (d) the different practices of aid organizations with respect to the authority and capability of field level representation, and to programming at headquarters; (e) the usefulness of forward planning is sometimes seriously hampered by uncertainty concerning the availability of future funds due to parliamentary procedures or the need (as was the case of UNDP in 1982-84) to interrupt or abandon ongoing programs because of large funding shortfalls; and (f) the ability, or willingness, of aid agencies to coordinate among themselves their country level planning varies from one country to another, and from one subject to another.

2.38 The developing countries also differ with respect to their ability to develop a planning framework or to create an efficient coordinating machinery to cope with TA. Some typical problems are prioritizing requests for assistance from various government departments and negotiating agreements with donors. The absence of a government agency

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19/ UNDP, Report to ECA on Aid Coordination. October, 1986.

20/ For example, the annual budget cycle for UNDP starts January 1; for the Bank, July 1 and for USAID October 1. No doubt there are other variations.

which combines the skills required to analyze TA needs and priorities and negotiate with donors often leads to inefficiencies in directing aid effectively towards the most urgent objectives. Even where such a single organ exists it is often ignored either by other government entities or by the donors.

2.39 Against a generally mixed picture of accomplishment in TA, the example of Botswana stands out as a success. This is not only because Botswana's management of TA reflects good overall public sector management but also because it has an efficient system for handling TA. It consists of (a) including TA in national development planning and manpower budgeting so that skill gaps are assessed on a sectoral and macro rather than on a project-by-project basis; (b) integrating temporary TA-supplied expatriate staff into the structure of the civil service; an (c) coordinating and centralizing the planning and administration of TA. Because of its selective use of TA personnel to perform tasks to which it was fully committed, Botswana has one of the best records of TA utilization. It would be helpful to many small African countries to look closely at the experience of Botswana in the management of TA.[21/]

21/ Public Sector Management in Botswana: Lessons in Pragmatism.

III: THE ROLE OF THE BANK

3.01 The Bank has built a distinguished record in development -- both as a leader and innovator. Unfortunately, the record in TA is uneven. TA appears for the first time in the Articles of Agreement of IDA (but not of IBRD) and the Bank has relied on UNDP and other major donors to provide the leadership in this area. While the Bank has taken many actions aimed at improving the effectiveness of TA, most of them are reactions to perceived problems and are modest in magnitude and impact. It is not clear, however, whether the Bank could have done much more, given the weight of its contribution to TA which amounts, for example, to hardly 10% of all TA to Africa, almost all in the form of loans and credits which the countries are a priori reluctant to accept. We believe that the Bank must reassert its leadership role in this important field. Toward that end a number of actions are recommended below, in addition to what has already been done.

A. Bank's Actions Aimed at Improving the Effectiveness of TA

3.02 The Bank has already taken several steps to improve the flow and impact of TA. The Project Preparation Facility (PPF) and the Special Project Preparation Facility (SPPF) enable borrowers to obtain resources quickly and easily. The TA Program for IDA Countries, although modest, makes available about 20-30 staff years of non-reimbursable Bank-staff services. Training both for Bank and recipient country staff has been stepped up and diversified. EDI has held seminars on the management of TA for senior civil servants from African countries. The Bank's Training Division sponsors a short course on the lessons from TA which has proved effective. EMENA established in 1985 a computerized TA database which provides data on all aspects of TA -- studies, expert services and project-related training -- and includes performance ratings of these activities. Other Regions are considering the establishment of a similar database.

3.03 The Bank gained considerable experience in dealing with TA, much of this experience has been incorporated into the Operational Manual Statements No. 2.15 on PPF, No. 4.00 on Technical Assistance and No. 4.30 on The Bank and UNDP, all of which have been a useful tool in guiding the process of designing and implementing TA.

3.04 The most important lesson the Bank has learned is that the process of preparing TA projects ought to be a more collaborative one between the Bank and the borrower. Another lesson is the need to establish performance standards for each sub-project and to prepare a detailed schedule of expected substantive outputs associated with each sub-project and responsibilities assigned for their implementation. In the case of staff recruitment or the provision of administrative and logistic support, the respective obligations of the Bank and the borrower are increasingly defined by both parties and their feasibility assessed prior to the start of project activities.

3.05 The Bank is fully aware of the intensified borrower reservations regarding TA, particularly in Africa. A number of measures have been, or are being, taken to enhance staff awareness of borrower concerns when proposing TA components and in designing them. It is encouraging borrowers to subcontract with UN Specialized Agencies to provide a range of soft TA including training. It is actively promoting the training of national staff and the development of local consulting capacity. Also, given the growing reluctance of countries to use borrowed funds for TA, the Bank has become active in seeking UNDP funding and has proposed an extension of the SPPF after its present commitment authority expires at the end of FY87. Finally, a new compensation policy for secondment staff was introduced by the Bank on January 1, 1987, which will effectively reduce the cost of secondment (non-Bank) staff by as much as 10 percent without sacrificing quality.

3.06 In Sub-Saharan African countries the Bank, singly or in collaboration with UNDP, has taken a number of measures to rationalize the processes and procedures pertaining to TA, aimed at reducing the burden imposed on weak recipient administrations. The first result of this collaboration was a Joint Bank/UNDP Technical Co-operation Assessment Mission in Somalia.[22/] UNDP has since taken the lead role in this endeavor and the Bank plans to participate in at least four other TA assessment missions during the next two years. The Bank and UNDP have also concluded in 1986 an agreement on aid coordination that would enhance the collaboration between the two institutions on TA matters.

3.07 Since the introduction of structural adjustment lending and sectoral loans, freestanding TA loans have been designed to address policy issues, strengthen economic and financial management, provide training in relevant skills and reform public enterprises. More than a third of SALs has been accompanied by parallel TA projects and the Bank has also financed TA to strengthen core economic institutions in more than 20 countries not receiving SALs such as Zambia. Sub-Saharan African countries account for a total of 38 projects amounting to 60% of the total loans for TA during 1982-86.

3.08 For example, a series of TA projects in the 1980s to Ghana, Sierra Leone, Togo and Zambia reflect a distinct evolution away from traditional TA and an increased awareness of the need to proceed modestly and slowly; the Ghana project also introduces a new feature, as does a project under development in Senegal. It proposes to mobilize private Ghanaian consultants to undertake studies and other activities as long as civil service salaries remain too low to attract or retain qualified specialists in the public sector. This "local skills mobilization scheme" encourages long and short term assignments in the public sector for Ghanaians now working in the private sector and includes an incentive provision in the form of a lump-sum resettlement allowance to attract home Ghanaians now working abroad. In both the Ghana and Zambia cases, the TA effort was carefully geared to selected interventions in a few areas where reform seems real stic and the projects are planned as part of a continuing and long-term process.

22/ UNDP and IBRD, Somalia: Report of a Joint Technical Cooperation Assessment Mission (October 1985).

B. Actions to be Taken

3.09 A central factor in improving the effectiveness of TA is the enhancement of the countries' planning and implementation capacity. The Bank therefore proposes to take various measures to help achieve this objective. These include:

- Improving TA Coordination
- Improving Coountries' Planning Framework for TA
- Encouraging the Use of Local Capacity

Improving TA Coordination

3.10 System overload is a product of uncoordinated assistance by numerous donors. The joint Bank/UNDP Report on Somalia called on the donors "to move forward from the present system of passive exchanges of information to more active coordination, in order to resolve common problems, to increase the eventually supportive effects of donors' assistance and to devise concerted policies and procedures..." Aid coordination is obviously not the sole responsibility of the World Bank, nor should it be. But the Bank will work closely with UNDP and other donors in placing TA on the agenda of both consultative groups and roundtables, particularly those for African countries, and seek to work with donors and recipients on improved TA coordination at the country level. We are mindful however, of the problems of TA coordination and the need to be realistic about it. As was stated by Mr. Wheeler, DAC's Chairman:

> "The donors differ one from another. They respond to a variety of decision-making processes and policy signals. It is wrong to think that donors easily co-ordinate one with the other, or that they come to the country with unified prescriptions. Indeed, one of the problems with achieving the very best results from technical assistance today is that donors have a variety of ideas as to what is the best approach. It may take considerable talking together to get everybody on board supporting a common sector strategy. But, again, the investment in this process of consultation is worth it."

Improving the Countries' Planning Framework

3.11 The Bank will assist interested governments in Sub-Saharan Africa in the establishment of a TA planning framework within the context of a national manpower plan. The objective would be to match anticipated managerial and technical skill needs with sources (national cadres and expatriate TA) potentially available to fill those needs. Possible benefits to be derived from this coordination effort would include a reliable and systematic basis for enhancing government's understanding of the need for TA, shaping national training programs, and transforming TA into a program which is demand based rather than supply-driven. Toward this, the Bank will help strengthen national management of TA by incorporating it, where appropriate, as a component of future public sector management projects. In future projects dealing with public sector management, particularly in Sub-Saharan African countries, Bank staff will generally be required to include specific provisions for improving national management of TA or explain why this is not being done.

Encouraging the Use of Local Capacity

3.12 It has been the policy of the Bank to further support the development of local capabilities, including local consulting services, in its TA work. The Bank is considering two measures to support this objective: (a) using whenever possible local consulting firms in Bank-supported projects, to broaden their experience; and (b) including training for local consultants in Bank supported projects. Local consulting firms can also benefit by entering into joint ventures with international firms as an effective means for the transfer of know-how. When these joint ventures are truly collaborative, they expose local firms to the working style, experience and technologies of foreign firms, and provide a basis for additional future collaboration. For the foreign firm, the joint venture offers eligibility to compete for government-financed contracts where affiliation with local partners is the norm (as is increasingly the case in many borrower countries); a reduction in field personnel costs and expanded awareness and knowledge of local conditions. For the client government, the joint venture presents an opportunity for development, through training, of local professional resources and continuing on-site representation by the consultants for any necessary follow-up.[23]

Reporting on TA

3.13 As noted in para. 2.02, there is a definitional problem concerning the reporting on TA in the Bank's Annual Technical Assistance Report, and the distinction between "soft" and "hard" TA does not appear to be satisfactory or to have been consistently applied. It is therefore proposed to undertake the following actions: (a) determine, through further discussions at the Bank and UNDP and through special studies, which among the components of Bank lending can properly be classified as TA; (b) issue guidelines to staff on the method of classifying TA in the SARs; and (c) introduce a new series of figures beginning with the 1988 Annual TA Report to reflect the new classification, with an appropriate transitional arrangement. Relevant information pertaining to the Report is being computerized and up-to-date data on TA will be available to the Executive Directors, on request.

23/ While the Bank does not object to joint ventures, certain conditions need to be observed including, in particular, the avoidance of naming specific firms, or prescribing the manner or extent of participation of the local firms.

TECHNICAL ASSISTANCE ACTIVITIES DURING 1982-86

1. Technical assistance has always been important in the Bank's operations as a complement to financial resources for investment. And of late, the Bank has increasingly relied on TA because of the diversification of its expanded lending portfolio, the intensification of its institutional development efforts, and the growing complexity of its operations, particularly in structural and sectoral lending. Such TA falls into three categories: (a) Bank-financed TA which is the largest category and accounts for 90 percent of project-financed TA. Other TA in this category includes "freestanding" TA loans, the Project Preparation Facility (PPF) and the Special Project Preparation Facility (SPPF); (b) TA financed from the administrative budget, including Country Economic and Sector Work (CESW), project preparation and supervision, the work of the Economic Development Institute (EDI), TA provided as part of the cooperative programs with FAO and UNESCO, the TA Program for IDA Countries and other forms of ad hoc TA diffused across many Bank departments (such as advice on debt management); and (c) TA administered but not financed by the Bank, as when the Bank serves as executing agency for UNDP-financed projects or provides reimbursable TA to capital-surplus countries or to the International Fund for Agricultural Development (IFAD). The purpose of this Annex is to highlight these activities and to provide data on their order of magnitude within the overall picture of Bank's support for TA.

A. Bank-Financed Technical Assistance

2. Most that the Bank finances is directly related to the implementation requirements of the investments it helps finance. During FY82-86, almost 90 percent of the Bank's support for TA was provided through project-related components. In recent years, these components have included preinvestment studies (intended to lead to projects), expert services for project development and implementation, institutional development, project related training and engineering services for project design and construction.

3. In terms of sectoral distribution agriculture is the largest beneficiary of project related TA, averaging 23.9% in FY82-86, followed by education (14.1%), transportation (13.6%) and power (11.3%). With the exception of education, fellowships and other software, the share of project-related TA in the various sectors is approximately comparable to the share of the sector in the total lending of the Bank (Annex I, Table 1). On the other hand the distribution of sectoral TA between hard and soft is significant but not surprising. As is expected, TA in human oriented sectors, such as education and population, health and nutrition is overwhelmingly soft while in the energy and power sectors it is predominantly hard. For example, in education and energy the ratio of hard to soft is 1:6 and 4:1 respectively. On the basis of our analysis of the data for FY82-86, summmarized in Annex I, Table 2, we have detected no significant trends over the period under consideration.

TABLE 1: Comparison between Lending by Sector and TA Components in FY82-86 (percentage)

Sector	Sector Lending	TA Components
Agriculture and Rural Development	25.4	23.9
Education	4.7	14.1
Transportation	13.3	13.6
Power	15.6	11.3
Other Sectors	41.0	37.1
TOTAL	100.00	100.00

Freestanding Technical Assistance Loans

4. The earliest freestanding TA loans were the project feasibility studies financed as special engineering loans in the 1960s and 1970s. The principal advantage of the policy and institution-oriented freestanding TA loans which have become more prominent in the 1980s is that they facilitate dealing more intensively with country management and institutional constraints than is possible under most investment projects, where physical and operational objectives typically receive a higher priority. Freestanding TA loans are also used when TA requirements are too diverse or multisectoral to be included as components in a normal investment project. This category accounted for an average of 8% of lending for TA in FY82-86.

5. In FY86 lending for freestanding TA reached $137.9 million compared with an average of $101.6 million for each of FY82-86. It is even more significant that, during FY1986 the size of a freestanding loan has risen from an average of $8.6 million in FY82-86 to $12.5 million, or an increase of 45%. This increase may reflect Bank's efforts to address policy and institutional development issues, public enterprise report, and training. A representative list of these loans is in Annex II. The two Africa Regions jointly account for about 60 percent of all freestanding loans in FY1982-86 (Annex I Table 3).

Project Preparation Facility

6. The Project Preparation Facility (PPF), established in November 1975, authorized the President to approve project preparation advances up to a total of $5.0 million. The Executive Directors have since approved six increases in commitment authority up to the present level of $99.5 million.[1/] The PPF is used to help finance small discrete tasks related

1/ At the time of the last increase, the Executive Directors agreed to express the commitment authority under the PPF on a net basis, taking into account the amount of advances that had been repaid or refinanced under subsequent loans or credits. At the same time, the upper limit of PPF advances has been increased from US$0.5 million to US$1.5 million per project. As the portfolio matured, the annual amount of new advances equaled the average annual amount of advances refinanced or refunded. Because this situation is expected to continue, a request for an increase in the net commitment authority is not anticipated in the foreseeable future.

Table 2
TA COMPONENTS IN WORLD BANK LOANS AND CREDITS, FISCAL YEARS 1982-86
Breakdown of Hard versus Soft Technical Assistance (*)
(Percentage)

	FY82			FY83			FY84			FY85			FY86			FY 82-86		
	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total	Hard TA	Soft TA	Total
Eastern and Southern Africa	41.6	58.4	100.0	39.5	60.5	100.0	38.5	61.5	100.0	35.2	64.8	100.0	32.7	67.3	100.0	37.6	62.4	100.0
Western Africa	41.6	58.4	100.0	44.4	55.6	100.0	36.9	63.1	100.0	37.3	62.7	100.0	28.8	71.2	100.0	38.0	62.0	100.0
East Asia and Pacific	45.9	54.1	100.0	65.6	34.4	100.0	40.7	59.3	100.0	43.0	57.0	100.0	24.3	75.7	100.0	45.1	54.9	100.0
South Asia	62.5	37.5	100.0	71.1	28.9	100.0	63.3	36.7	100.0	58.9	41.1	100.0	40.1	59.9	100.0	60.6	39.4	100.0
Europe, Middle East, and North Africa	57.0	43.0	100.0	60.3	39.7	100.0	40.3	59.7	100.0	48.7	51.3	100.0	32.4	67.6	100.0	48.1	51.9	100.0
Latin America and the Caribbean	48.6	51.4	100.0	39.8	60.2	100.0	50.1	49.9	100.0	43.5	56.5	100.0	51.4	48.6	100.0	47.2	52.8	100.0
Total	48.3	51.7	100.0	56.8	43.2	100.0	44.1	55.9	100.0	43.6	56.4	100.0	34.3	65.7	100.0	45.7	54.3	100.0

(*) HARD Technical assistance refers to amounts allocated for services provided for supervision of project construction, assistance in drawing up bidding documents, detailed engineering, and technical and feasibility studies.

SOFT Technical assistance refers to managerial and financial advisory services, and training.

Table 3
WORLD BANK TECHNICAL ASSISTANCE LOANS AND CREDITS
FISCAL YEARS 1982-86
(US$ million)

Region	FY82				FY83				FY84			
	Number	Amount			Number	Amount			Number	Amount		
		IBRD	IDA	Total		IBRD	IDA	Total		IBRD	IDA	Total
Eastern and Southern Africa	5	0.0	30.7	30.7	1	0.0	6.0	6.0	4	5.0	21.6	26.6
Western Africa	3	16.0	10.0	26.0	3	11.0	15.0	26.0	5	0.0	53.9	53.9
East Asia and Pacific	0	0.0	0.0	0.0	0	0.0	0.0	0.0	1	0.0	10.0	10.0
South Asia	1	0.0	7.0	7.0	1	0.0	6.0	6.0	3	0.0	35.0	35.0
Europe, Middle East, and North Africa	0	0.0	0.0	0.0	1	4.5	0.0	4.5	0	0.0	0.0	0.0
Latin America and the Caribbean	2	8.8	0.0	8.8	1	10.2	0.0	10.2	2	9.5	0.0	9.5
Total	11	24.8	47.7	72.5	7	25.7	27.0	52.7	15	14.5	120.5	135.0

Region	FY85				FY86				FY82-86				
	Number				Number	Amount			Number	Amount			%
		IBRD	IDA	Total		IBRD	IDA	Total		IBRD	IDA	Total	
Eastern and Southern Africa	4	0.0	27.8	27.8	6	7.6	45.8	53.4	20	12.6	131.9	144.5	28.5
Western Africa	6	13.0	34.7	47.7	1	5.0	0.0	5.0	18	45.0	113.6	158.6	31.2
East Asia and Pacific	0	0.0	0.0	0.0	1	0.0	20.0	20.0	2	0.0	30.0	30.0	5.9
South Asia	0	0.0	0.0	0.0	0	0.0	0.0	0.0	5	0.0	48.0	48.0	9.5
Europe, Middle East, and North Africa	1	0.0	4.7	4.7	1	0.0	12.0	12.0	3	4.5	16.7	21.2	4.2
Latin America and the Caribbean	4	29.5	0.0	29.5	2	47.5	0.0	47.5	11	105.5	0.0	105.5	20.8
Total	15	42.5	67.2	109.7	11	60.1	77.8	137.9	59	167.6	340.2	507.8	100.0

to project preparation for appraisal, and to help launch project implementation. PPFs are repaid when the Bank approves a loan for the project concerned, and are treated as a first charge on the loan.

7. The PPF has proved to be an innovative and successful instrument. In FY1975 18 advances were approved to five countries, totaling US$3.5 million. By 1986 50 new advances totaling US$35.6 million were approved, reflecting a steady growth in demand as well as an increase in PPF limit from $0.75 to $1.5 million. This tremendous increase is particularly significant in the light of the introduction of the Special Project Preparation Facility in FY1984 (para. 8). PPFs were used for project preparation largely in agriculture and rural development in Eastern and Western Africa. In FY1982-86, 202 advances (77 percent) were made to Eastern and Western Africa, 25 (9.5 percent) to Europe, Middle East and North Africa and LAC, and the remaining 9 advances to the other two regions (Annex 1, Table 4).

Special Project Preparation Facility

8. The Special Project Preparation Facility (SPPF), established in 1984 in the context of the Joint Program of Action for Sub-Saharan Africa, is a $10 million fund for investment-related preparatory work in Sub-Saharan IDA countries over a three-year period, FY85-87. The SPPF is used when other bilateral or multilateral sources are not available and when the PPF is unsuitable (because there is no immediate investment project or because there is uncertainty whether a project will materialize). Typical uses of the facility are macroeconomic, sector, or subsector work not immediately identified with a planned investment program or project; formulation of low-cost programs in education, training, health, population, agricultural research, and forestry; preparatory work for structural or sectoral adjustment loans; and institutional development (Annex 1, Table 5). SPPF advances are treated as conditional grants -- that is, they are repayable only if a project materializes in five years.

B. **Technical Assistance Financed Through the Administrative Budget**

9. As a development agency, the Bank provides a considerable amount of TA to its borrowers which is supported through its administrative budget. Such assistance has two components: direct and visible components which have an easily identifiable dollar value e.g., EDI's work, and contributions to Cooperative Programs; the other component which from a TA point of view is indirect, and less visible, and not easily measurable is the Bank's economic and sector work, and project supervision.

Country Economic and Sector Work and Project Work

10. In the course of its operational and policy work, the Bank regards itself as a partner in the development process, working together with the country in the design of policies, in the preparation of sectoral strategies, in project appraisal, in solving project and program implementation problems, and in evaluation of results. The TA implicit in this process is particularly effective and valuable to the country. The proportion of the Bank's administrative budget which can be considered as a form of TA however cannot be precisely quantified. (It is roughly

Table 4
PROJECT PREPARATION FACILITY ADVANCES
FISCAL YEARS 1982-86
(US$ thousand)

Region	FY82		FY83		FY84		FY85		FY86		FY82-86	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Eastern and Southern Africa	16	9,136.7	27	15,347.0	17	8,281.0	17	11,923.5	20	12,196.0	97	56,884.2
Western Africa	23	13,585.0	20	12,381.0	25	18,295.5	22	12,614.0	15	12,944.0	105	69,819.5
East Asia and Pacific	0	0.0	1	1,000.0	1	883.0	1	1,000.0	0	0.0	3	2,883.0
South Asia	4	1,277.0	0	0.0	0	0.0	1	600.0	1	750.0	6	2,627.0
Europe, Middle East, and North Africa	6	3,038.4	7	2,935.0	5	2,860.0	3	1,200.0	4	3,220.0	25	13,253.4
Latin America and the Caribbean	7	4,250.0	4	2,210.0	3	2,000.0	1	720.0	10	6,540.0	25	15,720.0
Total	56	31,287.1	59	33,873.0	51	32,319.5	45	28,057.5	50	35,650.0	261	161,187.1

Note: Number of PPFs refers to new advances only.
Amount represents or includes supplements approved during the fiscal year for earlier advances.

TABLE 5: Distribution of SPPFs by Activity, Region and Cost
FY85-FY87

Activity	EAN No. of SPPF	EAN Amount $000s	WAN No. of SPPF	WAN Amount $000s	BOTH REGIONS No. of SPPFs	BOTH REGIONS Amount $000s
(a) Macroeconomic/Sector/ Subsector Studies	12	2,540 1/	9	2,257 2/	21	4,797
(b) Formulation of low-cost Programs	n.a.	n.a.	3	210 3/	3	210
(c) SALs/Sector Loans Preparation	2	700	-	-	2	700
(d) Institutional Development	3	645	4	1,160	7	1,805
(e) Priority Projects for financing by other donors	2	1,000	-	-	2	1,000
(f) Others	n.a.	n.a.	2	500 4/	2	500
TOTAL	19	4,885	18	4,127	37	9,012

1/ Includes 3 SPPFs ($830,000) to identify preliminary investment programs for external funding.

2/ Includes 1 SPPF ($110,000) for other donors, 2 SPPFs ($750,000) for possible Bank investment.

3/ 3 SPPFs ($210,000) with possibility of other donors' investment.

4/ 2 SPPFs ($500,000) with possibility of other donors' investment.

estimated that 50 percent of the time devoted to country economic and sector work, 25 percent of project preparation/appraisal and 50 percent of project supervision might be regarded as plausible estimates.2/)

TA Financed in Cooperation with Other Agencies

11. The Bank finances TA in cooperation with UN specialized agencies, primarily through cooperative programs established with the Food and Agriculture Organization (FAO); the United Nations Educational, Scientific, and Cultural Organization (UNESCO); and the United Nations Industrial Organization (UNIDO).3/

12. Cooperative programs are intended primarily to increase the number and improve the quality of projects for Bank financing in agriculture and education. The Bank and the partner agency work together to help governments to identify and prepare projects suitable for Bank financing and to assist in implementation. Because it is also an objective of the programs to increase overall sectoral knowledge, they include provisions for sector studies and for involvement of cooperative program staff in economic and other missions. The Bank meets 75 percent of the direct costs. The partner agency meets 25% plus certain overhead and indirect costs (Annex 1, Table 6). The Bank's total contributions to these programs during FY82-86 was $44.3 million.

Economic Development Institute (EDI)

13. Also financed through the administrative budget is the work of EDI, the Bank's vehicle for mid-career training of senior officials from developing countries. EDI helps developing countries to strengthen their capabilities for analyzing policy alternatives and for designing and implementing development programs and projects. It does this through its courses and seminars, its training materials and case studies, and its assistance to training programs and institutions in developing countries (Board Document R86-92). The total cost of EDI activities for FY82-86 was $67.6 million.

Grant-Financed TA and the TA Program for IDA Countries

14. Before 1966 the Bank financed substantial TA through grants. Between 1966 and 1976 Bank policy permitted grant financing of TA to countries only in exceptional circumstances. The Bank has made no such

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2/ If one were to provide a dollar value to the TA elements inherent in economic and sector work, project identification and supervision, the figure would be about $650 million for the FY82-86, or approximately 39% of the operations budget.

3/ The cooperative program with UNIDO, which has been rather small, will be terminated at the end of 1987. A similar cooperative program with the World Health Organization was terminated in FY84 because UNDP is now funding the activities previously undertaken under Bank/WHO financing.

TABLE 6: World Bank Contributions to Cooperative Programs, FY1982-86
(US$ million)

Partner Agency	FY82	FY83	FY84	FY85	FY86	FY82-86
FAO	6.1	5.9	5.5	6.2	6.5	30.2
UNESCO	2.1	2.0	2.2	2.0	2.2	10.5
UNIDO*	0.3	0.5	0.2	0.2	0.2	1.4
WHO**	1.1	0.7	0.4	0	0	2.2
TOTAL	9.6	9.1	8.3	8.4	8.9	44.3

* To be terminated at the end of FY87.

** Terminated in FY 1984.

grants since 1976, with the exception of the TA Program for IDA Countries, the SPPF and some minor ad hoc TA. However, it is continuing to provide a grant to the Secretariat of the Consultative Group on International Agricultural Research (CGIAR), the research program on river blindness in Africa, the tropical diseases research program and the Special Program for African Agricultural Research (SPAAR). The total contribution for all these activities in FY82-86 was US$174 million.

15. In 1983 the Bank introduced the TA Program for IDA Countries, primarily those in Sub-Saharan Africa. Under this program, the Bank may assign its staff to government agencies, at their request, so long as the Bank is satisfied about the purpose and effectiveness of this type of assistance. Only Bank staff who have suitable qualifications and experience (e.g., in project preparation, macro and microeconomic analysis, financial analysis, external debt, sectoral planning, and monitoring and evaluation) are assigned to the program. The staff do not report to the Bank during their assignment, nor do they perform managerial or policymaking functions. Since the introduction of the program, 44 Bank staff have been assigned at a cost of $7.2 million.

Ad Hoc Assistance

16. The Bank also provides governments and intergovernmental institutions with ad hoc technical assistance. For example, the Bank has assigned members of its legal staff to develop legislation relating to investment policy in a number of countries and to assist governments and international organizations on specific Bank operations (such as establishing subsidiary loan agreements or drafting a charter for a national institution to be set up under a loan). The Operations Evaluation Department assists countries in developing monitoring and evaluation systems and provides training for their officials. Bank staff have become increasingly active in recent years in helping borrowers, particularly in Africa, improve external debt management, including debt reporting and centralized debt data systems, and the coordination of borrowing decisions. The cost of these activities, though considerable, is difficult to quantify.[4]

C. Technical Assistance Administered by the Bank But Financed by Others

Bank as Executing Agency for the UNDP

17. The Bank and the UNDP are the two largest sources of TA in the UN system. However, UNDP provides grant financing, often channeling it through projects implemented by an executing agency, the government, or the UNDP's Office for Project Execution itself. The Bank has served as an executing agency for UNDP projects since the UNDP's establishment in 1965.

18. The Bank has hitherto tended to act as a lender of last resort for TA. For TA (other than engineering) it is the Bank's policy to

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4/ For example, the Economic Analysis and Projections Department estimates its technical assistance input at 8 staffyears.

encourage borrowers to use grant financing from bilateral or other multilateral sources wherever possible. In particular, UNDP is accorded the right of "first refusal", and in consideration of this the Bank serves as executing agency for UNDP for a wide variety of projects. At the end of CY1986, the Bank was executing agency for 150 UNDP projects in progress whose total cost was $218.5 million.

19. The Bank uses the following criteria to decide whether to serve as executing agency for a UNDP project: (a) the relevance of the project to the Bank's lending program, reflecting the findings of its country economic and sector work; (b) the availability of Bank staff with technical competence to supervise the proposed project; and (c) the absence of conflict of responsibility arising from the Bank's role as a lender. As executing agency, the Bank is responsible for providing services such as hiring consultants, organizing training, purchasing equipment and supplies, reviewing reports prepared by consultants, and providing other backstopping support, which it does not normally provide under Bank-financed projects. The volume of UNDP funding of Bank-executed projects has grown from $15.5 million in CY1985 to $51 million in CY1986.5/ Indications are that it will stabilize at about US$50-55 million for each of the next five years, which corresponds to UNDP's Fourth Cycle, 1987-1991. The Bank is compensated by UNDP at the rate of 11 percent of disbursements, which approximately covers its executing agency costs. In calendar year 1986 the total fee was about $5.3 million.

20. An increasingly used feature of UNDP technical assistance is a form of joint financing called "cost-sharing," which permits non-UNDP funds to be added to a UNDP project to facilitate its completion. A common feature of cost-sharing is an arrangement between the UNDP and the Bank that permits borrowers to channel World Bank loan proceeds intended for TA into a UNDP project. The amount contributed by governments under cost-sharing forms an integral part of the project.

21. Many UNDP projects cover only a single package, study, or other assistance activity. But in a few countries -- including Burma, Bangladesh, China, and Mali -- the Bank executes umbrella projects that finance a series of preinvestment and investment support activities over several years. Under these projects, funds are available to respond to needs arising in various sectors and at different stages of the investment process. The specific uses of the UNDP funds are agreed to between the government, the Bank and UNDP in periodic assessments.

22. The growth of UNDP funding of Bank-executed projects is reflected in two other categories -- regional, and interregional and global. Regional projects cover two or more countries in a geographic region; for example, those dealing with environmental issues, women in development,

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5/ The growth of UNDP-supported, and Bank-executed projects may be attributed to a number of factors: (a) the reluctance of member countries to borrow for technical assistance (b) the availability of non-programmed UNDP resources; and (c) the creation in 1984 of a Bank/UNDP High Level Task Force on Collaboration and the subsequent appointment of an adviser in OPS on Bank/UNDP relations.

transportation planning in Africa, training by EDI and studies on the social aspects of structural adjustment in Africa. Among global and interregional projects being executed by the Bank are energy assessment, water pumps and sanitation, natural resource management and trade. These global and interregional projects have served both as catalysts for securing considerable additional funding from other donors, and as purveyors of TA and technology to member countries.

Reimbursable Technical Assistance

23. Since 1975 the Bank has provided reimbursable technical assistance to capital-surplus, oil-exporting developing countries. The Bank provides technical reviews of feasibility studies, proposals, or bids. It also conducts studies and offers advice on technical and policy issues, and assists in training national staff in a variety of fields. Nearly $33 million were provided under this program during 1982-86 (Annex 1, Table 7), with Saudi Arabia being the largest user of the program.

International Fund for Agricultural Development (IFAD)

24. Since its inception in 1977, IFAD has had a close relationship with the Bank. The relationship was formalized in 1978 in a framework agreement on cooperation under which the Bank, at IFAD's request, undertakes project identification, preparation, and appraisal and is then reimbursed. In accord with the agreement, the Bank applies its own methods, standards, and procedures in appraising IFAD-financed projects, but subject to IFAD's overall policies and criteria. Work done by the Bank for IFAD in FY1986 was equivalent to 12 staffyears.

Recruitment of Staff

25. The Bank helps borrowing countries recruit and place technical staff for a wide range of tasks. These staff may be employed under contract to the Bank (secondment staff) but financed from other sources (governments or the UNDP). Or they may be Bank staff temporarily assigned to work directly for a government (primarily under UNDP-funded projects or the TA Program for IDA Countries). At the beginning of 1987, 69 staff were on secondment, of whom 20 were regular Bank staff, primarily stationed in Sub-Saharan Africa.

Consultant Trust Funds

26. Several donor countries have recently begun to make available nonreimbursable grants (consultant trust funds) to support the Bank's operational work; the funds are intended principally to defray the cost of consultants hired from the donor country. These funds are to complement, not substitute for, Bank allocations from its administrative budget for consultant services. The Bank has established consultant trust funds with Belgium, Canada, Denmark, Finland, France, Ireland, Italy, the Netherlands, and Switzerland. Austria, The Federal Republic of Germany and Japan also propose to establish similar funds. Nine of the 12 donors have committed the equivalent of about $7 million to be used over 12 to 18 months. Three donors -- Norway, Sweden, and the United Kingdom -- have open-ended arrangements that allow them to examine ad hoc requests from the Bank.

TABLE 7: Reimbursable Technical Assistance, FY1982-86

Fiscal Year	Amount ($ million)	Staff Years
1982	5.9	29
1983	5.0	23
1984	6.5	25
1985	8.7	30
1986	6.7	28
TOTAL	32.8	135

SELECTED TECHNICAL ASSISTANCE LOANS AND CREDITS
FOR STRENGTHENING CORE ECONOMIC INSTRUMENTS
(US$ million)

Countries	Approval Date	Amount ($)	Features
Argentina	June 1986	18.5	Strengthening economic decision making, public investment policy and programming, public enterprise management, and industrial and export policies and procedures
Benin	November 1984	5.0	Improvements in macro-economic management, public investment programming, project preparation, and financial management and statistics, including training and fellowships
Brazil	June 1986	29.0	Strengthening public-sector planning and management in the areas of information, research, planning, budget, program implementation, and operational control, including supervision of state enterprises
Jamaica	May 1984	4.5	Strengthening and modernizing three core agencies (Ministry of Finance, Ministry of Public Service, Public Service Commission) and restructuring line ministries in program management format
Kenya	June 1986	11.5	Strengthening public sector institutions to deliver key services and formulate agricultural policy, with focus on policy analysis, management of resources, and implementation of programs and projects
Malawi	December 1983	1.5	Support for energy planning and coordination, studies of price controls and power tariffs, and strengthening debt management

Countries	Approval Date	Amount ($)	Features
Mali	December 1982	10.4	Policy reforms and institutional strengthening and training, with focus on economic policy analysis, public debt management, public enterprise restructuring, and civil service reform
Nigeria	December 1984	13.0	Strengthening management information systems, monitoring of debt and plan implementation, strengthening links between planning and budgeting, and training of planners
Pakistan	May 1984	7.0	Strengthening national economic planning, public enterprise reform, and studies of sectoral policies
Peru	September 1982	10.2	Introduction of program budgeting; public enterprise reform; review of civil service compensation; and improvements in debt management, public investment programming, tax administration, and statistics
Rwanda	March 1985	4.8	Training financial managers, improving procedures for budget preparation and execution, and strengthening policymaking
Sudan	May 1981	6.0	Support for project preparation and implementation, financial management, debt management, and statistics
Togo	June 1982	3.5	Support for economic policymaking and investment programming in Ministry of Planning, combined with public enterprise reform and assistance to Ministries of Rural Development and Industry and State Enterprises

Countries	Approval Date	Amount ($)	Features
Uganda	December 1983	15.0	Strengthening government decision-making, planning, project preparation, and implementation, including training
Yemen Arab Republic	March 1985	4.7	Strengthening Central Planning Organization in national economic planning and public investment programming in project evaluation and monitoring and maintaining a national data bank

A Comparison of "Hard" and "Soft" in Terms of Elements Necessary for TA Success: (Findings of an Indonesian Case Study)

"Hard" TA	"Soft" TA
1. All parties -- the client entity, the foreign and local consultants, and the donor -- agreed on the need for the TA and the assignment's objectives were clear, well-understood and accepted.	1. The concerned parties had conflicting ideas about the need for TA and its objectives.
2. The assignment was feasible because the requisite consulting knowledge and expertise existed: there was an established state of the art.	2. There was no accepted state of the art at the operational level for developing-country client entities.
3. Appropriate types and quantities of resources required to achieve the assignment's objectives were identified and provided: financing, time, consulting skills, and local logistical and administrative support.	3. Since the objectives were not resolved or clearly specified, the required resources could not be clearly identified or adequately provided. As a result, financing, time, consulting skills and local support all proved inadequate.
4. The assignment design included clear TOR for the consultant, and selection was made on the basis of appropriate technical expertise and prior experience.	4. TOR were vague and its coverage inadequate with regard to institutional development (ID). No ID background was required of the consultants; instead, they were selected on the basis of technical skills, with the result that many of them proved unsuitable for "soft" TA.
5. Adequate incentives were provided for the client entity in the form of top-level Government commitment and donor agency support, and for the consultants in the form of confirmed opportunities for repeat consulting assignments upon successful completion of work.	5. Donor policy was supportive of ID in principle, but in practice donor staff paid little attention to ID during TA supervision. Nor did the client entity direct or support the TA. And the consultants found that pressure to complete their assignment created a disincentive to do a good ID job.

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The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of Operations Committee to Consider
UGANDA - Economic Recovery Credit
Green Cover
Held on July 29, 1987 in Room E-1244

August 5, 1987

A. Present

Committee

Messrs. M.A. Qureshi (Chairman)
E.V.K. Jaycox (AFRVP)
S. Husain (LACVP)
W. Thalwitz (EMNVP)
A. Karaosmanoglu (ASIVP)
A. Shakow (SPERD)
D. Goldberg (VPLEG)

Others

Messrs/Mss. V. Dubey (EASDR)
C. Madavo (AF2DR)
K.Y. Amoako (AF2CO)
R. Liebenthal (SPRPR)
B. Tuncer (AF2CO)
K. Saito (AF2CO)
P. Ofosu-Amaah (LEGAF)
R. Myers (SPRPR)
S. El Serafy (EASDR)

B. Issues

1. The Operations Committee met on July 29, 1987 to discuss the Green Cover documents for a proposed Economic Recovery Credit to Uganda in the amount of US$50 million IDA Development Credit, and US$40 million from the Special Facility for Africa. The discussion followed broadly the agenda prepared by the Economic Advisory Staff, which raised inter alia questions concerning the appropriateness of rapid credit disbursements but a relatively slow pace of adjustment; the small coverage and slow expansion of the Open General Licensing systems (OGL); the appropriateness of the split of higher coffee revenues between the budget and producers; and the appropriateness of fixing both the exchange and interest rates.

C. Discussion

2. In an opening statement the Region indicated that with peace and good policies Uganda's economy had potential for rapid recovery and growth. The Government has moved significantly away from a "control" mentality and is committed to further reform. This credit is the first of a series endorsed by Management in the PFP.

3. Regarding the question of whether the pace of reform warranted such rapid expansion of imports and disbursements of IDA and other funds, the Chairman asked how much money was involved this year. The answer that it was approximately $180 million, led him to ask if the Government's commitment was at a comparably high level. The Region responded affirmatively and indicated that continued reforms and other aid pledges were dependent upon this credit going through quickly. Discussion shifted to Uganda's absorptive capacity and therefore its ability to use such rapid increases in inflows. The Region stated that the Government was attempting to attract expatriate Ugandans back, and reform the civil service to alleviate this problem.

4. The questions concerning the adequacy of the nascent OGL system and the split of increased benefits between the Government and producers induced a more general discussion on how and at what speed reform programs should be implemented. The Region indicated that it felt foreign exchange auctions had not worked well. One speaker mentioned that the Zambian reaction, i.e. abandoning reforms altogether, ought to be avoided. Another stressed the importance of recognizing that reforms should be broad based so that, e.g., investment licensing and credit availability were eased so as not to discourage the very activities which were the aim of the liberalization. The Chairman summed up by saying that he hoped the OGL system would be lightly rather than oppressively administered and that flexibility should be the watchword in implementing the reform program. It also seemed generally accepted that the split of the benefits from increased coffee revenues was appropriate.

5. The Region`s contention that both administered interest and exchange rates were appropriate was disputed by the Chairman. He added a macroeconomic perspective to the issue and stated that the Region seemed too timid on the subject. Freer, higher and more differentiated interest rates would improve financial savings, and the allocation of investment credit. There was also general skepticism that a secondary bond market between the banks would be competitive enough to establish a true "market" rate. The Chairman also expressed his expectation that the Bank and IMF would coordinate very closely in monitoring the agreed targets.

6. A final question was raised regarding the appropriateness of the 30% retroactive financing. The Region said this was essential. However, the Chairman and other Committee members expressed reservations about going to the Board with the proposal and suggested that another mechanism, perhaps a large revolving fund, might accomplish the same thing and be more acceptable to the Board.

D. Conclusion

7. In the light of the foregoing discussion the Committee gave sanction for the Region to proceed with negotiations taking into account the reservations made. The Chairman made a particular point about his reservations regarding the 30% retroactive financing and directed the Region to find another way of accomplishing that aim if possible.

August 3, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 27, 1987

TO: Operations Committee

V Dubey

FROM: Vinod Dubey, Director, EAS

EXT: 78051

SUBJECT: Jamaica: Country Strategy Paper - Change in Time of Meeting

Discussion of the Jamaica Country Strategy Paper will be held one-half hour earlier, at 2:30 p.m. on Wednesday, July 29 in Room E-1244.

File CSP

cc: Messrs. Loh
Voyadzis
Ryrie
Liebenthal
El Serafy
Ray
Steer

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Qureshi

DATE: July 22, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS
V Dubey

EXT: 78051

SUBJECT: UGANDA - Economic Recovery Credit

1. The Uganda Economic Recovery Credit will be discussed at an Operations Committee meeting on Wednesday, July 29, 1987, at 4:00 p.m. in Room E-1244. An agenda for the meeting will be issued shortly.

cc: Messrs. Madavo, Amoako, Myers

/df

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 27, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

Dubey

EXT: 78051

SUBJECT: Uganda: Economic Recovery Credit - A Proposed Agenda

1. The Uganda Economic Recovery Credit will be discussed at an Operations Committee meeting on Wednesday, July 29, 1987 at 3:30 p.m. in Room E-1244. The Committee may want to consider the following.

Background

2. The Government of Uganda is engaged in an effort to pull its citizens back into the official economy and to increase their economic output. To accomplish this it has embarked on a reform process and is borrowing considerable amounts of quick-disbursing foreign exchange in order to significantly expand imports. If it is to succeed in its aims it must appropriately match the pace of reform with that of disbursements of foreign exchange so that the real incomes and production of its citizens rise at a similar pace. If imports and incomes rise too fast there is a danger that the foreign exchange will be wasted. If too slow, producer incentives and production will be too low. Given past political instability in Uganda and the wariness of its people, the Government must successfully balance the rate of reform with the pace of foreign borrowing if it is to successfully maintain its credibility with its people.

The Pace of Reforms and High Cost of Failure

3. The present government's willingness to change economic policies is evidence of pragmatism and commitment to genuine economic progress. The Bank has played an important role in this process. However, the proposed rate of expansion of imports from this and other quick-disbursing loans suggests that the pace of reform must also be rapid to be successful. Otherwise the reforms might fail and the Government might abandon, perhaps for several years, its reform efforts. The cost of designing and implementing an incomplete or too slowly paced reform program, one which does not rapidly bring about a significant supply response, can therefore be very high.

- Can the Region explain why it feels that the speed of reforms is consistent with the pace of disbursements? Are the recommended policy changes sufficient to bring about timely economic improvements and hence reinforce Government commitment and willingness to proceed further?

- o <u>Given that rapid improvement in the allocation of foreign exchange is crucial to success, is the small size and slow expansion in the coverage of the OGL system consistent with the need to show results quickly?</u>

- o <u>Also, can the Region assure the OC that the splitting of the benefits, of increased coffee revenues, between the Government budget (via taxes) and producers (via higher prices) will sufficiently improve both the budget and coffee production</u>?

<u>Consistency Between Exchange and Interest Rates</u>

4. Exchange and interest rates are the primary determinants of the value of the Ugandan shilling vis-a-vis other currencies. Yet during at least the first year of the reform program both these rates are to be administered by the Government. This raises the possibility that the rates the Government establishes may be inconsistent with one another. The most usual inconsistency (the one possible in Uganda) an overvalued exchange rate and too low interest rates, leads to capita flight and domestic economic instability. The alternative would be to let one of the rates move freely so that it can adjust to consistency with the other, administratively established one.

- o <u>Can the Region explain why, given the unwillingness of the Government to adapt a foreign exchange auction, it has not included flexible interest rate determination as an element of the reform package</u>?

- o <u>What procedures will the Region recommend to the Government to ensure that the two rates are set at levels which are consistent with each other?</u>

cc: Messrs. Sandstrom
Amoako
O'Brien
Tuncer
Liebenthal
Myers
Ms. Saito

22759
07/20
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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

cc T Bourdon
cc: Mr Dubey

DATE: July 20, 1987 CONFIDENTIAL

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 72283

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File

SUBJECT: CHILE: Bank Commitments regarding SAL III

1. At the Operations Committee meeting on the SAL III Initiating Memorandum, you asked for details of the Bank's prior commitments to provide a Third Structural Adjustment Loan to Chile. In summary, we can say that discussions over the last two years among the Government, commercial banks, other external creditors and the Bank created a climate of expectation bordering on commitment. Project design and timing of disbursements were left open to negotiation.

2. A series of three SALs were discussed from the beginning and affirmed in the context of SAL II negotiations. The SAL II President's Report circulated in October 1986 makes reference to the expectation of a third SAL. Last August, in negotiating SAL II, we insisted Chile get a commitment from commercial banks to finance the 1987-88 financial gap (before second tranche). This was reiterated during the 1986 Annual Meetings. To meet this condition, the Chileans developed their financial projections by October, which were then revised by the IMF, and subsequently accepted, in early November, by the commercial bank Steering Committee economists.

3. At each of these stages, the Bank made clear its intention to support the structural adjustment program through the period under consideration, which involved a third SAL. The general amount of $250 million from the World Bank was incorporated into the financial projections of all four parties (Chile, Fund, banks, Bank) from which the remaining gap was calculated. The commercial banks in turn through their Steering Committee relayed to the Bank their expectation to reach an understanding on meeting the remaining financial gap. In the final version of the Financial Package, a condition to effectiveness of rescheduling of 1988-1991 Chilean public sector debt is full compliance with a third World Bank SAL or equivalent loan, if approved by January 1, 1988.

4. A third SAL operation was discussed by the Bank (SVPO) with the Chilean Finance Minister during the visit of the latter to Washington this April. These understandings were the basis upon which senior management authorized the May identification mission for SAL III.

5. It should also be noted that in the protracted rescheduling negotiations of November 1986-February 1987, the Government, the Bank and the Steering Committee considered several variations of a B-Loan--over and above the third SAL--to cover the approximately $400-450 million of the gap ultimately filled from the controversial retiming mechanism. These options were eventually discarded. ?

Cleared with and cc: Mr. Bottelier, LA4DR
cc: Messrs. Eigen (o/r), Tyler, Newfarmer, LA4CO

CJones-Carroll:ab

The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of Operations Committee to Consider
CHILE - Third Structural Adjustment Loan
Initiating Memorandum
Held on July 7, 1987 in Conference Room C-1006

July 15, 1987

A. Present

Committee

Messrs. M. Qureshi (Chairman)
S. Husain (LACVP)
W. Thalwitz (EMENAVP)
I. Goldberg (LEG)
J. Wood (FPBVP)
J. Holsen (PPRCEC)

Others

Messrs./Mss. T. Baudon
S. El Serafy
P. Eigen
P. Bottelier
W. Tyler
M. Selowsky
R. Newfarmer
C. Jones-Carroll
R. Liebenthal
F. Levy
F. Aguirre-Sacasa
R. Harris
A. Steer
C. Loser (IMF)
P. Brenner (IMF)

B. Issues

1. The Operations Committee met on July 7, 1987 to discuss the Initiating Memorandum for a proposed Third Structural Adjustment Loan to Chile in the amount of $250 million. The discussion followed broadly the agenda prepared by the Economic Advisory Staff which raised inter alia the questions of comparative shares in Chile's financial gap and the heavy burden of interest paid on foreign debt; the adequacy of savings and investment; the rationale of a SAL that maintains the adjustment momentum rather than supporting significant new initiatives; whether this operation should be more refocused towards the financial sector; the monitoring of the proposed conditionality and the operation's high risk; and the various studies begun under previous loans.

2. The Region stated that the adjustment process in Chile had been pursued with determination; that there was broad agreement between the Bank and the borrower on policy change; and that this operation would support an ongoing program and its proceeds were part of the financial projections on which was based a refinancing package already agreed between Chile and its creditors. The Chairman expressed doubt about whether the adjustments

supported by this loan had not been "bought" already under previous SALs, and whether the additional reforms being pursued, useful as they may be, are not really peripheral. Is there anything the Chileans might do, he asked, which would reduce the interest burden, the basic fragility of the program, or the risks of this operation? In these circumstances what should the Bank's role be?

3. The Region reiterated the difficulty of Chile's financial situation, with the heavy burden of interest on foreign debt impinging on real progress already made through the exchange rate, liberalizing the trade regime, broadening the export base, increasing agricultural production and exports, rationalizing public investment, and carrying out an impressive program of debt-equity conversions of about $1.3 billion. Economic growth, the Region added, was in the neighborhood of 4-5 percent a year and Bank exposure in Chile was not at all excessive. The first two SALs addressed the macroeconomic framework and the second one in particular focused on reforming the financial sector and its institutions. The proposed operation could reform the pension funds' role in intermediating their considerable savings to finance private sector investments -- a longer term problem of Chile's financial sector. It was thought appropriate, the Region said, that SAL III should support continuity of macroeconomic adjustment, while extending the reforms to the social sectors. This being a politically transitional period, it was more important than ever to keep the adjustment on course while addressing the social cost of adjustment. Coverage of the social sectors in the Initiating Memorandum may need improvement, but reforming the social sectors was of great importance. A study has been undertaken to develop a program of reforms in the health sector in particular where the Government lacked such a program. The Region added that SAL III was likely to be the last structural adjustment loan; that the emphasis in the lending program would shift to sectoral loans; and that the Chileans were already informed of this.

4. The Chairman stated that the social sectors were indeed important, and should be properly covered, with conditionality clearly defined on the basis of a deeper dialogue. Although the Region said that the financial sector had been rehabilitated, he still saw great need for reforms, particularly to mobilize savings and rationalize investment allocations. Reform of the pension funds and the social security system were key elements, but he found missing a broad thrust to strengthen savings performance.

5. A speaker, while accepting that a SAL could be an appropriate tool to sustain adjustment, questioned the overall size and quick-disbursing character of this operation. The projected pattern of net disbursements from the Bank to Chile over the next few years did not seem to fit into any medium-term assistance strategy. It was not obvious why this loan had to disburse so quickly. Were not the required reforms in the social sectors longer-term in nature, to be pursued over a longer disbursing period? His understanding was that this loan was not necessary for triggering any inflows from other sources. The Region said that the Bank's contribution was an integral part of the financial package for 1987 and 1988, and that the loan was needed if the Chileans were to meet IMF targets.

6. The speaker questioned the share of the Bank in the financial package. The commercial banks are not increasing their exposure, and the IMF is taking funds from Chile. With the various risks elaborated in the Initiating Memorandum, the speaker continued, are we justified in proceeding with this size of operation and the proposed speed of disbursements? Should not adjustment lending be made contingent on the commercial banks doing more?

7. Another speaker returned to the issue of a SAL operation being justified on the grounds of balance of payments support and maintaining ongoing reforms. He was afraid the proposed approach might set a precedent. The intention to shift to sector loans suggested that there must be sectoral reforms which needed to be addressed through adjustment lending. The Region replied that sector investment loans were the alternative they were considering after completion of the proposed SAL. While sector reforms would be explored, it was essential that policy gains on foreign exchange, the trade regime, and public sector investment should be consolidated and not be allowed to be reversed. The Region added that although the long-term debt problem should be the center of the adjustment process, a point emphasized by another speaker, Chile had already completed its 1987-88 restructuring negotiations, and the Bank should await progress on Brazil, which is currently negotiating with its creditors, before considering new debt approaches.

8. The Chairman thought that we might be morally committed to proceed with the loan if an agreement had already been reached on the Bank's contribution to Chile's financial needs, especially as our exposure was low. But the Region should let him have a note on the specific commitment made. He thought that the Debt Management and Financial Services Department should also look at Chile's debt restructuring and burden-sharing.

9. The Region then gave an account of the studies financed under previous loans. Two studies had been completed and a third was progressing satisfactorily, and virtually all of them were yielding useful results. One study, that of management of public enterprises, was overtaken by the Government's speedy program on privatization, and has thus been rendered unnecessary.

C. Conclusion

10. In the light of the foregoing discussion the Committee gave sanction for the Region to proceed with appraisal, taking into account the reservations made. In particular the Chairman directed that the reforms in the social sectors should be pursued in depth, and be part of a comprehensive program that should be better presented and articulated with appropriate conditionality. He expected a note from the Region clarifying the Bank's commitment towards filling the financial gap. He also directed that because of the various issues raised this operation should be discussed by the Policy Committee, but that appraisal should nonetheless proceed as planned.

July 7, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 6, 1987

TO: Operations Committee

FROM: for Vinod Dubey, Director, Economic Advisory Staff

EXT: 78051

SUBJECT: CHILE: Structural Adjustment Loan III - Initiating Memorandum - Agenda

1. The Operations Committee will meet on Tuesday, July 7, 1987 at 4:00 p.m. in Room C-1006 to consider the Initiating Memorandum (IM) for a proposed Third Structural Adjustment Loan to Chile in the amount of $250 million.

Bank Lending and the Commercial Banks

2. The proposed amount of the loan is equal to each of the two former two SALs which were approved, respectively, in October 1985 and November 1986. Adjustment lending in FY88 would constitute 82 percent of the lending program as compared with 55 percent and 68 percent in FYs 86 and 87, respectively. Total lending was $456 million in FY86 and $366.5 million in FY87, and is projected at an average of about $320 million in FY88-92. The IM (para. 65) draws attention to the projected increase between 1986 and 1992 in the share of the Bank in net disbursements, and in total debt and its servicing. By contrast, Annex 3, page 2 shows negative net inflows from the IMF in every year from 1987 until the end of the projection period. As with previous SALs and the 1985 B-loan, the current operation is important for bridging the 1987-88 financial gap, but perhaps more important by its policy provisions for rallying the international financial community's assistance to Chile. However, the commercial banks continue to be reluctant to increase their exposure. The Committee may wish to take up the following issues:

- Is the Bank assuming too high a share in Chile's financial gap?

- "What will the Bank do in Chile if, despite the best economic policies, the commercial banks steadfastly refuse to increase their exposure in 1989-90?" [A question raised by Mr. Husain in his covering memorandum.]

- As the partial IBRD guarantee of a US $300 million B-loan had been pivotal in bringing in the commercial banks on the 1985-86 financial package, is there scope for a similar initiative in 1987?

- Would the Region clarify the "alternative focus of interest rate relief" which it is proposing for Chile and Brazil?

The Macroeconomy and Loan Rationale

3. The adjustment program begun in 1985 and supported by the two previous SALs has resulted in a gradual improvement of key indicators including the trade balance, non-copper exports, and domestic savings, but the heavy debt burden, particularly the service interest which absorbs some 10 percent of GDP as well as the precarious terms of trade, provide grounds for concern. The second tranche of SAL II was released last month after a mixed, but on the whole satisfactory performance. Certain aspects of the macroeconomy remain obscure and the Region may wish to throw light in particular on the following:

a) Savings remain depressed, and private investment which was 15.6 percent of GDP in 1980, became about 7 percent in each of 1984, 1985 and 1986, and is projected to rise gradually to 10.5 percent by 1992 [Annex 3, page 1]. Why does private investment remain depressed if the policy framework has improved and contains "no major disincentives" to such investment (para. 17)? The constraints on investing private pension funds described in paras. 43 and 44 appear too great to be left to "developing a program" for them by tranche release.

b) How much of the 7.2 percent growth in agriculture in 1986 (para. 7) can be attributed to the adjustment program and how much to exogenous factors?

c) The IFS shows that consumer prices rose at an annual average rate of 21.5 percent between September 1986 and March 1987. A provision under SAL I was that the Government would complement the fiscal austerity measures with a monetary policy capable of lowering inflation from 23 percent in 1984 to 15 percent in 1987. What is the record of inflation in 1987 and why does it remain problematic?

4. The IM makes a case for the need to sustain previous efforts at adjustment through the proposed loan which, rather than begin new initiatives, seeks to consolidate the achievements already secured and support the momentum for policy change that is already in train.

- The Committee might consider the merit of the argument that though this loan does not support any new policy changes it is justifiable on the grounds that it fills part of the financial gap and sustains already initiated reforms. In other words, does the Region see an end to this seemingly unending process of adjustment lending to Chile?

Monitorability and Risk

5. As described in the IMF, SAL II program represents a continuation of undertakings already in place with detailed provisions to sustain improvements in public health and the social security system. No firm conditionality emerges from either the text or the matrix on policy changes contained in Annex 2. This, taken together with the high risks elaborated

candidly in the nine paragraphs 58-66, particularly those associated with the Central Bank's foreign debt obligations and the fragility of the financial system, suggest the following questions:

- o Should not the focus of this operation shift significantly to the financial sector, with emphasis on improving the incentives to savers and rationalizing the allocation of funds for investment?

- o Are there too many details in the provisions proposed for the social sectors? Can these be translated into monitorable actions so that conditionality can be clarified and better serve implementation?

- o Are the risks of this operation altogether too high?

Studies

6. Under previous loans several studies were initiated or endorsed to guide later policy change. These included under SAL I (a) a study of the most exportable products in the short term and measures to promote their exports; (b) two employment generation studies -- one to recommend reforms for cost-effectiveness and prepare an action plan to reduce the two emergency employment programs, and the other to analyze the composition of the labor force and explore possible interventions to enhance employment; (c) a study to improve public administration focusing on design and implementation of organization and information systems that would lead to improving control and management of public enterprises; and (d) a study of Chile's competitiveness in the international sugar market. Under SAL II a condition of second tranche release was the completion of a study on public enterprise management financed under the FY85 public sector management technical assistance loan; and of another on the likely growth of pension fund resources; and satisfactory progress of a study of the health sector.

- o The Region may wish to give a brief progress report on the status of these studies and indicate what steps, if any, are to be taken under the present operation to expedite their completion and translate their conclusions into action programs; and whether in retrospect these studies appear to have been warranted.

cc: Messrs. Eigen, Scherer, Bottelier, Wessels, Selowsky

Messrs. Baneth, Holsen, Lee, Rao, Shakow
Baudon, El Serafy

June 18, 1987

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

(1)

DATE: June 15, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, Economic Advisory Staff V. Dubey

EXT: 60061

SUBJECT: ARGENTINA: Banking Sector Adjustment Loan - Initiating Memorandum - Agenda

1. The Operations Committee will meet on Thursday, June 18, 1987 at 12:00 p.m. (not Wednesday, June 17, as previously announced) in Room E-1208 to consider the Initiating Memorandum (IM) for a Banking Sector Adjustment Loan to Argentina in the amount of $250-300 million. The final amount would be determined by the extent of the financial reforms agreed to. The loan would be in two tranches and the implementing agency the Central Bank of Argentina. Total lending to Argentina was $544.5 million in FY86; $944 million in FY87 and is projected to total $850 million in FY88 and $1.0 billion on average in FY89-90.

- The Region might wish to give an updated account of the external gap and how this is being filled by the Bank, the Fund, the commercial banks and other sources; what the recent rescheduling arrangements have been, and what is envisaged by way of rescheduling for the future. How is the rescheduling going? Role of the Bank/Fund

Adjustment Lending

2. The present operation would be the third adjustment loan to be processed for Argentina after the FY86 $350 million Agricultural Sector Adjustment Loan, and the FY87 $500 million Trade Policy Loan.

- Export performance Loan etc. As the Trade Loan was only approved last month, the Region may wish to report on the progress of the reform program under the Agricultural Sector Adjustment Loan. The second tranche of that loan was originally expected to be released in January 1987. When does the Region expect this now to be released? Progress of the reform program

Stabilization and the IMF

3. Despite the shock-treatment of inflation and the economic deficits effected through the Austral plan, initiated two years ago, political and other pressures have kept impinging on the adjustment process. A good case is made in the IM for the necessity of reforming the financial sector of Argentina, given the many weaknesses prevailing which hinder economic recovery: segmentation of deposit and credit markets; hidden subsidies through multiple discount lines; and scarce and costly credit to the private sector. The fear of inflation, further devaluations and large public sector deficits dominates the market for credit, raising real lending terms. This is also reinforced by large spreads charged by

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lending institutions, which reflect their weak portfolio positions, high reserve requirements and forced investments. The IM relates all this to what it describes as the process of "financial disintermediation", "strong demonetization", and the "extremely short-term" orientation of the financial system. Despite certain signs of improvement in the economic balance, the problem of inflation appears to remain intractable. Inflation averaged of 7.4 percent a month in the first quarter of this year, which translates to an annual rate of 136 percent. The IM (para. 2) admits that "economic stability is yet a distant goal", and the Region recommends (para. 16) that compliance with agreements reached with the Fund over inflation, public sector deficit and the exchange rate (an IMF report on which would be available later this month) should be a sine qua non for Board presentation, loan effectiveness and second tranche release.

- o <u>The Committee might discuss if a financial sector reform program along the lines proposed is feasible at all given the intractability of inflation.</u>

4. Para. 68 which addresses "project risks" states that "Compliance with the agreements reached with the IMF ... will provide the minimum required macroeconomic framework". The IM mentions various monetary and credit variables that would be included in quarterly reports that would help in assessing implementation. These serve to indicate the areas of the macroeconomic framework (over and above inflation, the public sector deficit and the exchange rate, the main IMF concerns) which the Region would monitor.

- o <u>The Region may wish to expand on the way the results obtained from the measurements could be translated into performance criteria.</u>

- o <u>Should stabilization falter, instead of suspending the financial reform program altogether, is there an alternative design that might produce structural improvements until stabilization is reassured (see below)?</u>

<u>Program Design</u>

5. The present operation is said to be the first in a series of loans that would provide the framework for a comprehensive and gradual approach to reforming the financial sector of Argentina, beginning with the banking sector (para. 5). Subsequent loans would attend to restructuring public banks, reducing marginal reserve requirements, and developing the capital markets. In view of this, the present operation looks diffuse and overburdened with detailed changes and conditions. The policy matrix contains 28 conditions (13 for Board presentation, two for effectiveness and 12 for tranche release). Instead of setting the stage by defining long-term objectives, delineating the various stages of future reforms while focusing this operation on a set of priority measures, this particular operation seems to have the following objectives: a) deregulation of deposit and lending markets through reduction of forced investments, reserve requirements and rediscounts; this is to be done through detailed and specified regulation of these quantities; b) reduction

in future rediscount lines and coordinating the value of rediscounts with reserve requirements which should be publicly disclosed; c) rationalization of the rediscounting processes by agreeing on a formula to adjust principal to inflation as a step towards establishing market interest rates on Central Bank rediscounts; d) establishment of a system of uniform and non-discriminatory reserve requirements, elimination of regulated deposits and regulated lending, and eventually all controls on interest rates for deposits and lending; e) restructuring public and private banks according to action plans to be agreed upon; and f) institutional reforms to improve the supervisory powers of the Central Bank, improve the processes of bank liquidations and streamlining the management of rediscounts.

6. The Central Bank seems to be endowed with powers to enable it to behave in a manner that arbitrarily drains funds from deposit banks through interest-free reserve requirements and forced investments in Central Bank bonds, while redirecting funds through rediscounting commercial paper inordinately in favor of regional state banks, thus contributing to the difficulties of many financial institutions and raising the cost of intermediation.

- o Instead of going into excessive details as suggested for regulating levels of various variables, is it not easier to agree on a set of medium-term objectives, leaving the details to be agreed upon under action plans? Central objectives vs details

- o Short of changing the banking law in a way that would reduce the Central Bank's arbitrariness in the distribution of credit, should not the focus of reform be the Central Bank itself in order to clarify its role in monetary policy and financing the public sector?

Technical Assistance

7. In FY86 the Bank made an $18.5 million "Public Sector Management Technical Assistance Loan" to Argentina in order to strengthen the Government's management of the economy, including its efforts to "develop and strengthen the tools needed for coherent economic policies and decision making", "increase domestic resource mobilization" and "strengthen the performance of and restructure public sector enterprises". The key objectives of that operation were "to produce more effective and integrated policy development, national statistical services, sector and project analysis, multi-year investment planning and control, tax collection, public enterprise management, and trade and industrial policies. [President Report No. P-4320-AR, dated May 13, 1986] In the covering memorandum to the IM the Region mentions a Preparation Facility Bank grant of $100,000 made last year to support the design and implementation of a computerized information system to provide information on reserve requirements, forced investments, and Central Bank rediscounts at each financial institution level.

8. It is not clear from the IM how the technical assistance provided under the FY86 loan has profited the financial sector of Argentina, and whether the Central Bank's superintendency of Banks, which "does not have a

clear picture of the financial situation of the 304 banks and NBFIs it supervises" (IM, para. 37) was excluded from the reforms which the technical assistance was meant to promote.

- <u>The Region may wish to give the Committee a progress report on implementing the FY86 TA project, and to explain if there is any overlap between its objectives and those of the present operation.</u>

To what extent TA 86 was used to provide input to prepare Program for fin sector

9. Attached are two tables prepared by the LAC Region showing key macroeconomic variables.

Attachments

cc: Messrs. Eigen, Scherer, Bottelier, Wessels, Selowsky

Messrs. Baneth, Holsen, Lee, Rao, Shakow
Baudon, El Serafy, Levy, Barandiaran

ARGENTINA

KEY MACROECONOMIC INDICATORS

	Actual				Projected				
	1983	1984	1985	1986 p	1987	1988	1989	1990	1991
GDP growth rate	2.8	2.6	-4.5	5.7	4.0	3.6	3.7	3.8	3.7
GDY growth rate	2.1	3.4	-5.9	4.8	3.8	4.0	4.2	4.5	3.8
GDY/capita growth rate	0.5	1.8	-7.3	3.2	2.3	2.5	2.6	2.9	2.3
Consumption/capita growth rate	1.9	4.0	-8.2	6.6	0.7	1.4	1.4	1.5	1.5
Debt Service 1/ 2/	13303	9888	8139	6674	6374	5743	6934	7875	8531
Debt Service/XGS (%)	133.7	96.1	77.6	75.9	64.1	50.9	55.5	59.5	60.6
Debt Service/GDP (%)	20.5	14.5	12.6	10.1	9.1	7.6	8.6	9.0	9.1
Gross Investment/GDP (%) 4/	14.2	12.4	10.5	11.8	12.6	13.5	14.4	15.3	16.1
Gross Domestic Savings/GDP (%)	18.8	17.1	17.6	14.8	16.0	17.0	18.0	19.3	19.9
National Savings/GDP (%)	10.4	8.3	9.2	9.2	10.7	12.3	13.5	14.6	15.5
Marginal National Savings Rate	0.05	-0.72	-0.09	0.10	0.49	0.56	0.46	0.43	0.40
Public Investment/GDP (%)	7.3	6.1	6.1	5.3	5.6	5.9	6.2	6.5	6.8
Public Savings/GDP	-5.2	-2.3	1.9	3.2	3.7	4.5	5.0	5.2	5.6
Private Investment/GDP (%) 4/	6.9	6.3	4.4	6.6	7.0	7.6	8.2	8.8	9.3
Private Savings/GDP	24.0	19.4	15.7	11.6	12.3	12.5	13.0	14.1	14.3
Public Investment/private investment	1.1	1.0	1.4	0.8	0.8	0.8	0.8	0.7	0.7
Government Revenues/GDP	21.7	22.9	27.3	27.0	27.3	27.6	27.9	28.0	28.0
Government Expenditures/GDP	33.1	31.2	31.4	29.0	29.1	29.0	29.2	29.3	29.2
Deficit (-) or Surplus (+)/GDP	-11.4	-8.3	-4.1	-2.0	-1.8	-1.4	-1.3	-1.3	-1.2
Export Growth Rate 3/	11.5	0.1	14.6	-8.6	12.1	2.9	3.6	3.1	3.1
Exports/GDP (%) 3/	14.7	14.3	17.2	14.9	16.0	15.9	15.9	15.8	15.7
Import Growth Rate 3/	-2.4	4.6	-13.9	16.9	9.1	6.3	6.2	5.6	5.1
Imports/GDP (%) 3/	10.2	10.3	9.3	10.3	10.8	11.1	11.4	11.6	11.7
Current Account Balance 1/	-2461	-2392	-953	-2645	-2227	-1866	-1702	-1561	-1481
Current Account Balance/GDP (%) 1/	-3.8	-3.5	-1.5	-4.0	-3.2	-2.5	-2.1	-1.8	-1.6
Interest Coverage ratio	0.54	0.60	0.85	0.41	0.53	0.58	0.60	0.64	0.66
Interest/ Exports of GNFS	0.57	0.55	0.50	0.49	0.42	0.37	0.36	0.37	0.34

1/ At current US dollars.
2/ Excluding short term principal repayment
3/ At constant prices.
4/ Includes changes in stocks.

Notes:
Debt includes public and publicly guatanteedivate non-guranteed and short term debt.
Exports and imports include goods and non-faices.

June 12, 1987

ARGENTINA - BALANCE OF PAYMENTS, 1980-1995
(US$ millions at current prices)

	Actual							Projection				
	1980	1981	1982	1983	1984	1985p	1986e	1987	1988	1989	1990	1995
Exports of Goods and NFS	10765	11545	9525	9512	10028	10242	8797	9939	11295	12502	13234	18075
Merchandise (FOB)	8021	9143	7624	7836	8107	8396	6987	7735	8868	9917	10641	14724
Non-Factor Services	2744	2402	1901	1676	1921	1846	1810	2204	2427	2585	2593	3351
Imports of Goods and NFS	14024	12537	7195	6581	6709	5891	7025	7750	8854	9747	10092	14481
Merchandise (CIF)	10541	9430	5337	4564	4584	3814	4700	5250	6104	6818	7153	10695
Non-Factor Services	3483	3107	1858	2017	2125	2077	2325	2500	2750	2929	2939	3786
Resource Balance	-3259	-992	2330	2931	3319	4351	1772	2189	2441	2755	3142	3594
Net Factor Income	-1531	-3700	-4719	-5408	-5712	-5304	-4422	-4421	-4307	-4457	-4703	-4593
(interest payments)	2175	3850	4926	5423	5537	5132	4291	4168	4230	4561	4905	4635
Net Current Transfers	23	-22	32	16	3	0	5	5	0	0	0	0
Current Account Balance	-4767	-4714	-2357	-2461	-2390	-953	-2645	-2227	-1866	-1702	-1561	-999
Long-Term Capital Inflow	4188	9484	7658	2793	-488	4782	4802	1870	1879	1902	1812	1000
Direct Investment	788	927	257	183	268	919	574	125	200	240	280	436
Official Capital Grants	0	0	0	0	0	0	0	0	0	0	0	0
Net LT Loans (DRS data) 1/	2855	7088	5756	972	-295	2770	1099	820	1095	1185	1242	-411
Other LT inflows (Net, DRS) 1/	545	1469	1645	1638	-461	1093	3129	925	584	477	290	975
Total Other Items (Net)	-2217	-8228	-5952	-88	3143	-2965	-3125	372	0	0	-1	-1
Net Short-term Capital	-1780	-8093	-5446	-935	-1664	-2384	-4186	0	0	0	0	0
Capital Flows N.E.I.	0	0	0	0	0	0	0	0	0	0	0	0
Errors and Omissions	-437	-135	-506	847	4807	-581	1061	372	0	0	-1	-1
Changes in Net Reserves	2796	3458	651	-244	-265	-864	968	-15	-13	-200	-250	0
Net Credit from IMF	0	0	0	1173	0	1007	146	818	-13	0	0	0
Other Reserve Changes (- indicates increase)	2796	3458	651	-1417	-265	-1871	822	-833	0	-200	-250	0
As shares of GDP:												
Resource Balance	-5.2	-1.5	3.8	4.5	4.9	6.7	2.7	3.1	3.2	3.4	3.6	2.9
Interest Payments	3.5	6.0	7.9	8.4	8.1	7.9	6.5	5.9	5.6	5.6	5.6	3.7
Current Account Balance	-7.6	-7.4	-3.8	-3.8	-3.5	-1.5	-4.0	-3.2	-2.5	-2.1	-1.8	-0.8
Long Term Capital Inflow	6.7	14.8	12.4	4.3	-0.7	7.4	7.2	2.7	2.5	2.3	2.1	0.8
Net Credit from IMF	0.0	0.0	0.0	1.8	0.0	1.6	0.2	1.2	0.0	0.0	0.0	0.0
Memorandum Item:												
GDP (millions of current US$) 1/	62628	64091	61983	64834	68047	64665	66326	70372	75486	81041	87048	123795
Foreign Exchange Reserves:												
Internat'l Reserves (mil. US$)	6719	3268	2506	1172	1243	3124	..	..	..	..	..	..
Gold (end yr. London price)	195	179	169	161	150	168	..	..	..	..	..	..
Reserves incl. Gold (mil. US$)	6914	3447	2675	1333	1393	3292	2470	3303	3303	3503	3753	3753
Reserves in Months of Imports	5.12	2.52	2.65	1.33	1.36	3.58	2.62	3.33	3.03	2.94	3.00	2.36
Exchange Rates (Australes/US$):												
Official X-Rate (Australes/US$)	0	0	0	0.01	0.07	0.6	0.95	..	..	..	..	..
Index Real Eff. X-R Base 1980	100	77.10	50.69	42.71	49.77	44.02	..	..	..	..	..	..
X-rate for GNP Conversion	0	0	0	0.01	0.08	0.61	1.12	..	..	..	..	..

1/ DRS data and Argentina Division estimates.
2/ Figures adjusted by 1983 parity between the US $ and Argentine currency.

June 12, 1987

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE June 15, 1987

TO Mr. Moeen Quereshi, SVPOP

FROM V. Rajagopalan, VPPRE

EXTENSION 32707

SUBJECT ARGENTINA - Banking Sector Adjustment Loan

Due to a prior and conflicting commitment, it will unfortunately not be possible for me to attend the Operations Committee meeting on the above loan that has been rescheduled for Thursday of this week.

The proposed loan is seen as one of a series. There are, therefore, two essential conditions for its success. First, an appropriate macroeconomic framework including: (a) a low and stable rate of inflation; (b) a low combined public sector deficit; and (c) a realistic exchange rate. It would be useful to explore the prospects for such a framework. In that context, the respective roles of the Bank and the Fund in monitoring such a program is germane.

Second, continuing government commitment to reform of the banking sector is also essential. The October 1986 reforms were a step in the right direction. But, the February 1987 "temporary" measures indicate a backsliding. Also, the course of banking legislation has been contentious. As a clear expression of government commitment to reform, it is essential that the February 1987 measures be reversed in the very near future.

The program outlined for the loan is a good one in general. It does, however, treat public and private banks asymmetrically. This asymmetry, although motivated by political resistance from public institutions, has consequences for public industrial enterprises and could, more generally, jeopardize the effectiveness of the reforms. The appraisal mission should be encouraged to tackle more vigorously the problems of public banks.

Finally, financial sector reforms could, in the short term, aggravate financial distress and lead to banking and corporate failures. What are the "safety net" features--including industrial restructuring--accompanying such a program? Without them, social and political pressures may build against further reforms.

cc: Mr. Dubey

June 12, 1987

Minutes of Operations Committee to consider
ECUADOR -- Financial Sector Adjustment Loan -
Initiating Memorandum
Held on June 12, 1987, in Conference Room E-1208

July 1, 1987

A. Present

Committee:

Messrs. M. Qureshi (Chairman)
S. Husain (LACVP)
E. Jaycox (AFRVP)
A. Karaosmanoglu (ASIAVP)
W. Thalwitz (EMENAVP)
V. Rajagopalan (PPRVP)
I. Shihata (LEG)
J. Wood (FPBVP)

Others:

Messrs. T. Baudon
D. Lee
V. Dubey
S. El Serafy
G. Terrier (IMF)
F. Lysy
P. Scherer
T. Hutcheson
M. Thobani
P. Eigen
P. Bottelier
W. Tyler
M. Carriozosa
T. Hill
J. Collell

B. Issues

1. The Operations Committee met on June 12, 1987 to discuss the Initiating Memorandum for a proposed Financial Sector Adjustment Loan to Ecuador. The discussion followed roughly the agenda prepared by the Economic Advisory Staff, which had raised, inter alia the issues of political feasibility and Government commitment; whether linking interest rates to a CD rate would reduce the power of the Central Bank over monetary policy; technical assistance for the superintendency of Banks; and whether the stabilization bonds to be issued by the Central Bank at market rates would further squeeze the resources of that Bank.

2. The Region explained how the collapse of petroleum prices and the March earthquake had seriously undermined the stabilization program. The IMF representative said that compliance with the 1986-87 Stand-by became impossible after the earthquake. The Stand-by was now cancelled and Ecuador has expressed the intention to negotiate a new Stand-by. Meanwhile Ecuador has requested emergency assistance from the Fund. The Region noted that it expected an IMF Program to be in place before negotiations, at which time agreement will have been reached on filling the financial gap.

3. A speaker wondered, given the political situation what guarantee the Bank would have that any agreement reached with the present Government would be honored and whether we should confine our lending to projects. The Chairman saw the need for financial sector reforms, but asked if the work done would be wiped out by a change of Administration. The Region said that without policy reforms Ecuador would be uncreditworthy for project lending, and an agreement with commercial creditors might also be jeopardized. The present Administration appeared committed to the reforms, but many elements in the opposition are critical of them. In view also of the unconstitutionality decision on interest rates, and the fact that the Region expected Board presentation in November 1987, two months before the elections, the Chairman expressed concern about the possible politicization of this operation which seeks inter alia to move towards the elimination of subsidized credit. He wondered whether a new administration might reverse the reforms introduced under this operation. The Region judged, however, that the policies are unlikely to be reversed, adding that the new Government would not assume office until August 1988, and said that many contacts have already been established with opposition economists, many of whom understand the necessity of the reforms.

4. As to linking interest rates to market-determined CD rates, the Region said that while this would reduce the subsidy element in Central Bank credits, this would not detract from the powers of the Central Bank over monetary policy as other policy instruments were available to influence monetary aggregates. The Region also saw no danger in the stabilization bonds adding to the squeeze on the Central Bank resources as they would be limited in volume. The Region said that the concerns raised in the agenda about technical assistance to the superintendency of Bank were well taken and would be incorporated in the operation.

5. In the light of the discussion the Chairman summed up by saying that in view of the amount of work already done the Region should proceed with appraisal as planned, expediting the processing to distance the operation as much as possible from the January elections. Above all exceptional care should be exercised in view of the politically sensitive issues involved, and on account of creditworthiness considerations. Because of the Government's political constraints, and in order to assess progress towards closing the financial gap and agreement with the Fund on a new program, the Committee should review this operation again upon return of the mission and before devoting additional resources to loan processing.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 2, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, Economic Advisory Staff

EXT: 60061

SUBJECT: NIGERIA: Country Strategy Paper (CSP)

For your information the Operations Committee meeting scheduled for June 10, 1987 to discuss the Nigeria CSP has been rescheduled. The new date is Friday, June 12, 1987, at 3:00 p.m. The Agenda will be issued shortly.

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 2, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, Economic Advisory Staff

EXT: 60061

SUBJECT: ECUADOR - Financial Sector Adjustment Loan Initiating Memorandum

There will be an Operations Committee meeting to dicusss the abovementioned paper on Friday, June 12, 1987 at 4:00 p.m. The agenda will be issued shortly.

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 10, 1987

TO: Operations Committee

FROM: Vinod Dubey, Director, Economic Advisory Staff V. Dubey

EXT: 60061

SUBJECT: ECUADOR - Financial Sector Adjustment Loan Initiating Memorandum

1. The Operations Committee will meet on Friday, June 12, 1987 at 4:00 p.m. in Room E-1208 to consider the Initiating Memorandum (IM) for a proposed Financial Sector Adjustment Loan to Ecuador in the amount of $75 million. The Region is planning a total program of $210 million for FY88 including, besides this operation, a trade policy loan and a national housing project. Lending to Ecuador was $159 million in FY87 and $253.5 million in FY86.

2. The loan would support a program of policy and institutional reforms in the financial sector, aiming at strengthening the sector's institutions and enhancing their independence from the Central Bank, and generally developing the capital market. The IM rightly emphasizes the crucial role that has to be played by exchange rate policy, and indicates the hardships and political costs that would ensue on the various reforms being pursued, including the containment of the fiscal deficit and the current account gap. The Region draws attention to the fact that there is considerable uncertainty over the Government's ability to undertake the proposed program prior to the January 1988 elections, but suggests that appraisal should proceed considering its low incremental cost and in order to ready the operation for the time when an external financial package is in place involving the foreign commercial banks.

3. A Stand-by arrangement was made with the Fund running from August 1986 to August 1987, but only one purchase was made under it before it became clear that not all the targets could be met, particularly in respect of the public sector deficit. In January 1987 the Government suspended payments to commercial banks, but reached an agreement with the Fund in February on the main parameters of the 1987 program, pending debt rescheduling by the commercial banks, and action on public revenues. The March earthquake changed this undertaking and the Government has indicated its willingness to negotiate a new Stand-by. Contacts with the commercial banks are said to be continuing, with the bankers scheduled to visit Ecuador in late May (IM, para. 12).

- Could the Region update the situation regarding the commercial banks and the size of the financial gap? Comm Bks Fin Gap

- What are the chances of a Stand-by materializing in the near future? And if a Stand-by is not concluded, can alternative measures be worked out to safeguard the implementation of the proposed financial reforms? IMF Standby o Would the reforms agreed with the present Ecuadorian administration be acceptable to the next administration?

Interest Rates

4. The loanable funds market is fragmented and ridden with regulations. The Central Bank offers direct and indirect lines of credit at preferential rates. During a period of annual inflation of about 25%, market rates on deposits are 22-30% while interest charged to borrowers on Central Bank credits directly or through financial institutions ranges from 12 to 21%. Many credit transactions are effected administratively at forced interest rates, and to complicate matters subsidized interest is set in nominal terms and, though adjustable, is not explicitly linked to the market rate: when inflation rises, the subsidies also rise (para. 13). Although the Government has moved over the past two years to restrict growth of preferred credit and the share of central bank credit in total credit, subsidized credit remains very large and hinders the efficient allocation of credit, development of the equity market, and monetary stability (para. 25). The attempt by the present Government in August 1986 to free interest rates came "under serious attack" (para. 31) and was declared unconstitutional in a March 1987 ruling by the constitutional tribunal. An impasse over this issue appears to prevail between the President and Congress which has supported the tribunal's ruling. Further interest rate reforms are judged to be "the most difficult part of the reform" (para. 31).

o Against this background the Operations Committee may wish to assess Government commitment in the draft Declaration on Financial Policy to the effect that interest rates on BCE credit will be brought into closer alignment with market interest rates according to an agreed schedule (see below); that margins on retailing BCE credits will be reduced in order to reduce the financial institutions' stake in intermediating subsidized BCE credit; and that forced investments by the commercial banks of 10% of their demand deposits at subsidized Financial Funds terms will be reduced to 8%.

5. With the aim of reducing the subsidy element in preferential credit, the operation will seek to raise minimum lending rates on Central Bank credit while linking the latter rates to rates paid on Certificates of Deposit (CD). The IM (para. 43) states that in February 1987 the lowest interest charged to financial borrowers on Central Bank credit lines was 9 percentage points below the 90-day CD, yielding about 27%. The IM judges that a rapid reduction of this differential would not be politically feasible, but would be reduced to 7 percentage points by Board presentation and 5 percentage points by release of second tranche.

o The Region may wish to comment on the feasibility of such a program given political resistance and the constitutional issue.

o Even if such political hurdles are to be surmounted, what is the rationale for the Bank's support of the new set of interventions? Can a later target of liberalization of interest rates be determined and explicitly agreed to?

- o <u>In linking lending interest rates so passively to a CD or other market rates, does this not detract from the objective of making the Central Bank the ultimate authority over interest rates as a tool of monetary policy?</u>

<u>Strengthening Financial Institutions</u>

6. The financial intermediaries are too numerous and fragmented and largely illiquid or insolvent. They are not adequately supervised by the weak Superintendency of Banks (SB) which seems to pay more attention to forced investments than to the quality of the banks' portfolios. Provisions for bad loans are not sufficient and it is possible that the obligations of many financial institutions equal or exceed their net assets. The fragmentation and insolvency of many institutions contribute to the high cost of intermediation. When the Central Bank "sucretized" and assumed the foreign debt, this was meant to reduce the indebtedness of the financial intermediaries and their clients, but the authorities have been disappointed in their hopes of converting this into equity. The present operation envisages that a strengthened SB will, by Board presentation, be able to issue regulations to prevent accrual of interest on non-performing loans and require that recognized losses be written off immediately. By second tranche release, draft legislation will have been prepared to regulate capital adequacy in relation to risk assets in specific categories instead of to total liabilities as at present. Supervision in the interval will entail using discretionary powers to raise capitalization and reduce the leverage of commercial banks. Such an exercise of judgment would seem to require greater resources and better management than seems to be available to SB.

- o <u>The Region may wish to elaborate on the brief account given in para. 38 of the technical assistance necessary to provide SB with the research and analytical powers that would make it effective, and the time needed for building it up to meet its projected functions.</u>

- o <u>Should not SB rather than the banks' own auditors (para. 35) assess the quality of the portfolios?</u>

<u>Long-Term Finance</u>

7. Expectations of high inflation have stifled the markets for fixed rate mortgage bonds and other DFI long-term paper. Virtually all long-term lending has ceased except that funded by the Central Bank at fixed rates which carry a large and variable subsidy depending on market rates that tend to reflect inflation. Variable interest rates were introduced in 1985 in the context of the Bank's Industrial Finance Loan (para. 46), but these were made subject to the administratively-determined "maximum prevailing rate", set lower than the CD rates. Financial intermediaries therefore have been unable to raise resources while onlending them long-term at variable interest rates. Productive firms are highly indebted to the financial institutions and could use longer term funds if these can be mobilized. This means that rates have to be truly variable and set with a mark-up above the rate on CDs. The operation contains various provisions

to reform this situation including linking World Bank loans to market rates; introducing an auction market in Central Bank notes (stabilization bonds) that would be instruments of monetary control; developing an interest capitalization system to reduce the front-loading of amortization schedules in periods of high inflation, and various institutional reforms to encourage equity finance. A program of financial reforms will be defined before second tranche release, which will be the nucleus of a later operation.

- <u>Would not issuing stabilization bonds at market rates squeeze the resources of the Central Bank? And if the deficit of the Central Bank is thus increased, how will it be financed?</u>

- <u>If a declaration on positive interest rates on both borrowing and lending is to be obtained by the appraisal mission, how can this be implemented after release of the second tranche?</u>

cc: Messrs. Eigen, Scherer, Bottelier, Wessels, Selowsky

Messrs. Baneth, Holsen, Lee, Rao, Shakow
Baudon, El Serafy, Levy