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M. QURESHI'S
OPERATIONS CMTE

August – September 1988

September 14, 1988

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 12, 1988

TO: Messrs. V. Rajagopalan (VPPRE) and M.J. Petit (AGRDR)

FROM: Vijay S. Vyas (AGRDR) Vyas

EXTENSION: 37501 - Rm. J2261

SUBJECT: Response to Comments by Mr. Vinod Dubey on AGR Paper - <u>Strategic Issues for Agricultural Lending in Sub-Saharan Africa</u>

Please find below the main comments on the paper by Mr. Vinod Dubey and our response.

I. <u>Inconsistency between policy reform and investment projects</u>

The sub-title may be considered provocative. The main thrust of the section is correct. However, since it has raised a hornest's nest, some rewriting may be in order.

II. <u>Hybrid Lending</u>

i. Hybrid lending will downgrade the policy reform aspect.

This need not be the case. Africa Region is already practicing this approach. The paper clearly states "Hybrid lending operations should proceed only after agreement has been reached between the Bank and borrowers concerning the resolution of macro-policy issues and the design of a broad sector strategy" para 66. The same idea is presented in para 67.)

ii. Bank may be able to maximize its leverage on supply side measures through public expenditure reviews rather than through hybrid lending.

Only partially. In the context of SSA agriculture it is not only question of shifting resources, it is to invest <u>more</u> in different activities.

iii. Whether the pros and cons of hybrid lending have been adequately discussed.

In our view this is not a place to have an intellectual debate on pros and cons of hybrid lending, but if it is desired, this can be done.

III. <u>Institutional Development</u>

Whether past and present Regional initiatives have been adequately allowed for.

Changes in the Bank's lending strategy which reflect greater bias toward institutional development have been recorded (see para 35, and, especially para 36. Also, a reference is made to the study "Institutional development in Africa: A Review of World Bank Project Experience", (see para 75). Recent initiative in strengthening agricultural services has been pointed out in para 30.)

IV. <u>Borrower Commitment</u>

i. The report does not detail the extent to which the lack of borrower commitment and insufficient collaboration have actually been a problem.

There is a body of evidence on this issue referred to in OED report on the World Bank's Experience in Rural Development. The same views were expressed by a large number of staff.

ii. Will the increase in field staff in the Bank's resident missions bring about the improvement?

The pre-conditions for the successful collaborative planning are spelled out in para 101 to 106.

V. <u>Next Steps</u>

i. Should the focus be broadened to include other strategic concerns, such as food security and environment initiative, rural infrastructure, etc.?

No, the paper has selected three critical issues because they are relevant for the <u>process</u> of lending. The rationale for selecting these issues has been provided (see paras 21-23).

ii. Should the paper be geared to country specific discussion?

No, for the reason given in para 20.

iii. Should macro-economic side be discussed in greater detail?

Macro-economic side is being discussed in detail in another ongoing PPR study on Adjustment Lending. Paper makes it abundantly clear that macro-economic factors were important in explaining past, unsatisfactory, performance of agricultural lending in Africa. (See para 33).

iv. Past and present initiatives should be described in the paper.

To the extent they are germane for the discussion they have been discussed, (see para 34 to 37 and para 80 for regional initiatives; also, boxes in the sections on Institutional Development, box 5; and in the section on Borrower Commitment, boxes 6 and 7.)

VI. Suggested Future Steps

i. Section on "Inconsistency between Adjustment and Investment" will be shortened and rewritten.

ii. Discussion on "Hybrid" approach will be expanded.

iii. Tone and language will be suitably modified to make it appropriate as a Board document.

VSVyas:hrv

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

CONFIDENTIAL

OFFICE MEMORANDUM

DATE: September 12, 1988

TO: Mr. Moeen A. Qureshi

FROM: Anando Ray, Adviser, EAS

EXTENSION: 78073

SUBJECT: Brief for OC Meeting on "Strategic Issues for Agriculture Lending," Wednesday, September 14

1. The purpose of this note is to bring out a few points that I could not reflect in the Agenda. I shall first deal with macroeconomics and agriculture, in order to bring out the basic deficiency of the paper. I then comment on the "consistency" between policy reforms and investment projects.

2. During the Board discussion of the 12th annual report on Project Implementation and Supervision in March 1987, Mr. Shahid Husain had said that two studies were being done as a part of a package of measures to improve projects in SSA. This paper, then called the "Design of Agricultural Projects," was one of those studies which Mr. Husain promised to "bring to the Board" upon completion.

The "Macro-Micro" Linkages

3. The paper, prepared by Vyas and a team of consultants, was initiated in 1986 to "draw together available insights on improving project design for the agriculture sector in Sub-Saharan Africa, within a framework which takes into account key aspects of the macro environment..." (Agriculture Dept, Policy Brief, 1986).

4. Although the terms of reference required linkages to the "macro-environment," there seems to have been inadequate appreciation of what that means. The terms of reference defined the "macro-environment" as "the supply system which provides certain skills and physical and fiscal resources, institutional support and the policy milieu which a project has to take more or less as given." There was no mention of relative profitability and of the main determinants of the macro-micro linkages that had, by then, been well identified in Bank reports, viz real exchange rates, public expenditure allocations, revenue systems, and urban food subsidies.

5. The paper completely ignores the major lessons from Africa which have been:

(a) overall policies which influence the real exchange rate can have at least as much, if not more, profound effects on agriculture as sectoral policies;

(b) the anti-agriculture biases implicit in overall policies have been greatly exacerbated by agricultural policies at the sector level in African countries;

(c) a major factor in (b) has been the widespread public interventions and loss-making parastatal monopolies (however well-intentioned their initiations might have been);

(d) while the African countries have suffered because of the external environment, itself the product of highly distortionary policies in the OECD countries (particularly in EEC and Japan), they have made matters very much worse for themselves by adjusting to that environment in mistaken ways.[1]

6. The efforts of many African countries to promote industrialization behind high tariffs, their failure to prevent appreciations of the real exchange rates, and the urban bias in the allocation of their public expenditures, have all meant that farmers lost their incentives during the 1970s and 1980s. Movement away from rural areas was fast, and there was little incentive to maintain land which was allowed to degenerate. The environmental degradation in African rural areas was partially a form of decapitalization associated with the intersectoral movements of factors of production that one would predict in such circumstances.

7. These lessons are relatively new, having become very clear largely because of the pathological experience in Africa and in a few countries outside (e.g., Argentina and Bolivia). The traditionalist view, in contrast, emanates mainly from the much less traumatic experience of the Asian countries during the 1960s and early 1970s. The conception of agricultural projects as "hothouses" and "nurseries" which are protected against the macro-environment was not a damaging one in those relatively stable periods in countries with only mild anti-agriculture biases. In contrast to Africa, Asian countries have generally benefitted from better macro-policies. Macro-policies in Korea and Taiwan have had a strongly pro-agriculture bias; Thailand has had roughly neutral policies; and India, Indonesia, et. al. have exhibited at worst relatively mild anti-agriculture biases.

8. The Bank was absolutely right in shifting its focus in the 1980s to policy-based adjustment loans. This shift was an acknowledgement that the traditional project initiatives cannot succeed well in highly perverse macro-environments. Contrary to the Vyas paper, however, no one suggested that macro-policy reforms would be all that was needed to promote agriculture. It was always understood that good public expenditure and revenue measures would also include sound agricultural projects.

1/ All these and other lessons are well-established in the literature, although the first complete synthesis, taking account of OECD policies, was presented in the Bank's World Development Report of 1986. The lessons are also reflected, in varying degrees, in the series of special reports prepared for Africa since the early 1980s.

9. This paper makes a mistake when it suggests that we should downgrade policy-reforms and shift our focus back to the project-lending of the 1970s (the kind of subsectoral policy conditionalities that it has in mind were also common then). The paper also makes a mistake when it puts down policy reforms as being only short-term measures. It also makes a mistake in putting down policy reforms in Africa because they have not produced any "sudden improvements in performance (para 4)." First, the policy reforms are not complete; second, it takes time for new incentive systems to become credible and attractive to private resources; third, the reforms may well have prevented further retrogression of agriculture; and fourth, whether or not improvements have occurred, the paper ought to have at least presented the available evidence.

"Consistency"

10. I also want to add some remarks on Chapter 3 which deals with adjustment and investment lending. First, the section on Institutional Interventions (p25-27) is in conflict with the Bank's positions on the need to promote competitive private markets and divestments of uneconomic parastatal functions. This section suggests that the Bank's attachment to these objectives is excessive, and that privatization has been premature, inappropriate, and in conflict with the support to parastatals entailed in investment lending. In principle, this question of parastatal reforms needs to be discussed in terms of particular functions and activities (research and extension, for example, have long been recognized as important public functions). Paragraphs 81-86 of this report does a good job of it. Here, however, the discussion is in such general terms that it appears ideological.

11. More importantly, the conflicts referred to have not been successfully exemplified. While it is quite possible that the Bank's advice and conditionalities on parastatal reforms have been occasionally inappropriate, the paper fails to show this:

- its reference to parastatal budget reforms (paragraph 50) is unclear--it is not at all obvious a priori that the discontinuance of the various subsidies referred to would be inappropriate;

- the Box 1 on the Nigerian Cocoa Board is also misleading because (a) the Bank had nothing to do with its privatization, and (b) the criticism of the privatization is opaque; it is not shown that privatization was worse than the alternative.

12. The section on Prices and Subsidies (pp27-32) suggests that input subsidies are very good things that should not be trifled with. The Bank's position has been to endorse such subsidies only in a very selective manner. In fact Vinod's old CPD produced a good policy paper spelling out the criteria. This paper does not refer to the relevant criteria, and would be interpreted as a general endorsement of wasteful subsidies.

13. The section on Public Finance (pp32-34) is pointless, suggesting only that expenditure cuts often fall on high-priority items (such as extension, para. 59).

14. In discussing adjustments and investments, one should focus on how the economic circumstances of the day alter one's perception of public expenditure priorities. Some questions are:

- the relative prices of factors and products are quite different before and after adjustments. For example, labor becomes much cheaper than capital, both measured in terms of traded goods. What are the implications for types of investments and for types of project-designs? The investment pattern that was correct in the 1970s can no longer be correct. How well do our projects staff, and those outsiders who prepare projects, understand the new priorities?

- in particular, given the extreme scarcity of fiscal resources, one would favor activities that are relatively good for public revenues - other things being equal, projects with higher cost recoveries would be preferred. What are the implications for agriculture?

- what are the priorities in research and extension and how are they being related to the changes in economic circumstances?

- what are the priorities within "institutional development?" Given the strong macro-micro linkages and the need for flexibility in decision-making, how can agricultural policy-making be better integrated with overall policy-making?

Conclusion

15. The main thrust of the paper should be different. An appropriate articulation of the macro-micro linkages might be expected to lead to the conclusion that lending to support basic policy reforms should continue to be emphasized, particularly at a time when the structural adjustment process is far from complete in the African economies. The Bank's policy-based lending should include emphasis on public expenditure reviews to minimize the misallocation of public resources within agriculture and between agriculture and other sectors. In focusing on whether the countries concerned are spending enough current and capital resources on agriculture, the public expenditure reviews should enable the Bank to have wider leverage on the expenditure programs than possible through investment lending. Investment lending should of course continue to be used. In this context hybrid lending may be a useful lending technique and may deserve a mention in the paper. The question of recurrent cost financing may also be discussed.

Cleared with and cc: Mr. Dubey

ARay:vlw

A.Ray E-3075

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 9, 1988

TO: Graham Donaldson, Chief, OEDD1

FROM: A.J. Blackwood, OEDD1

EXTENSION: 32895

SUBJECT: Comments on Draft Paper "Strategic Issues for Agricultural Lending in Sub-Saharan Africa" August 15, 1988

You asked for rapid comments on this paper by AGR. Clearly, in the short time available I could not do the subject full justice but I hope that this contribution proves of use. I have summarized the main points in this note and my further thoughts are attached.

My understanding is that this is a proposed Board paper, but if so there would appear to be some way to go before the paper is finalized. In addition to some editorial problems, which will no doubt be picked up by others (jargon, catch-phrases, complex language etc.), I feel that the draft at present does not come very close to addressing some of the major issues facing agricultural sector lending operations in Africa. Its recommendations are none too clear and appear only loosely tied to the body of the text.

My main points are as follows:

- The very broad generalizations about Africa in the paper obscure rather than illuminate the issues.

- Consequently, the paper needs to dispose of early on those aspects of agricultural sectors in Africa which are shared and then devote most of its discussion to specific strategy issues for groups of similar countries or regions (I also query in the attached notes the title of the paper, which is not self explanatory as to the objectives of the discussion).

- I have suggested in my notes that it is to be hoped that staff and management will take the opportunity of this paper to simplify the complex task facing people working on agriculture in Africa by including in the paper clear guidelines (or boundaries as I have called them) on the major strategy issues.

We were especially asked to comment on whether this paper is factually correct in its retrospective sections and consistent with OED findings. My notes attached raised questions on the correctness of some of the paper's assumptions and examples, but these are based not only on OED work but also on personal experience working in

Africa. Although I have read the draft comments of others on this paper (which were sent to us), I have not chosen to relate my comments to these other comments for the sake of simplicity.

Attachment

cc:

Notes on Draft Paper "Strategic Issues for Agricultural Lending in Sub-Saharan Africa", August 15, 1988

Introduction

Unfortunately, I find this draft very unsatisfying. The paper, in common with several others on similarly broad subjects which have been circulated recently, seems to be another example of an attack on a complex subject mounted by insufficient resources and in limited time. It fails to draw on the considerable collective wisdom and experience of Bank staff, let alone on any external sources. Although the paper contains some good ideas and one or two novel suggestions, it does not by any means do justice to the very large and important topic suggested by the title. (The title of the paper itself may be a problem, as it is not immediately obvious, to this reader at least, what the precise topic is. Are the strategic issues related only to how to effect continuing Bank lending in Africa, or are they related to development strategies in agricultural sectors, or strategies for dealing with Borrowers, or all of these and others? The draft suggests that it is a combination of strategies for keeping the lending program filled plus an overlay of the strategies for effective development, but these are not necessarily complementary objectives.)

With respect to the title and focus of the paper, my preference would be to take a two-stage approach: first, discussing issues concerned with effective development of agricultural sectors, and second, exploring how the Bank's lending program can best contribute to such a strategy. Such an approach should give as much attention to what the Bank cannot or should not do, as to where it can be most effective.

The paper might also benefit from introducing a succinct section demonstrating the scale of the problems and the main characteristics of agriculture in comparison with other regions. One is often left with the lurking suspicion that relative to other regions some of the constraints and problems of Africa may be overstated. Such a section could help to confirm or dispel any such suspicions.

African Generalizations

But I am getting ahead of myself. My major overriding comment on the paper is that it falls into a common trap (perhaps induced by time and experience constraints) of making wild generalizations about Africa which, while convenient in gradeschool geography classes and the popular press, do not illuminate debate in institutions such as the Bank. For a paper such as this, my suggestion for dealing with the diversity of Africa would be first to discuss, fairly briefly, those aspects and issues which are common to most countries, (more on that later) and second, to discuss strategies for similar groups of countries, regions, environments, political systems, etc., in a carefully structured format. Such an approach would simplify the debate rather than complicate it as at present.

Lest anyone should think that the diversity issue is overstated, let me give some examples. It seems meaningless in most respects to discuss agricultural strategy for resource poor, management deficient, mini-economies such as most Sahel countries and Somalia in one breath with the likes of Côte d'Ivoire, Kenya and Zimbabwe. Similarly, discussing conflict-ravaged countries such as Mozambique, Ethiopia, Sudan and Uganda alongside Kenya, Tanzania and Malawi, which have experienced virtually no internal security problems for decades, seems likely to only cloud rather than clarify some of the issues. With respect to the "land frontier", although many African countries are densely populated in relation to productive land, some of these same countries would be the envy of populations in many parts of the Indian subcontinent, Java and the Philippines. Similarly, there are other African countries which have large areas of land which, given reasonable access and better control of tse-tse and malaria, would be highly attractive to farmers and ranchers from, say, Israel, Arizona, and South Australia. Politically, one has to distinguish between the relatively free-market economies and the non-market economies. There are also the special problems of the very small economies (the paper on small island economies is relevant) and of landlocked countries. In brief, trying to generalize about some 40 Sub-Saharan African countries which often differ from each other in more respects than they are similar, could be characterized as being as logical as trying to discuss agricultural development strategy for the states of Maine, Florida, Iowa and Arizona as a group.

Diversity and Opportunity

On the other hand, the diversity of the continent is one of its strengths, especially where economic and political associations can draw together complementary systems. Thus, the agricultural resource base ranges from pure desert through rangeland to semi-arid cropping land, high-potential mixed farming areas (especially at higher latitudes and altitudes) to significant areas of temperate sub-montain lands in some fortunate countries. In addition, there are extensive areas of high rainfall equatorial forest in several countries. The subject of irrigation potential, about which the draft paper is silent, deserves a paragraph of its own.

Irrigation

In an earlier related paper (?) the irrigation potential of Sub-Saharan Africa was virtually dismissed as insignificant on per capita grounds when compared with other regions. The problem of apparently high development costs was noted in passing, but the subject was pursued no further (the current paper ignores irrigation). Looked at from another perspective, depending on whose estimates are used, the physical irrigation potential of Sub-Saharan Africa is of the order of 20 to 30 million acres. This is roughly equivalent to, at the upper end, the irrigated area of Pakistan, and using a ballpark cost figure would require investments of US$150-250 billion to exploit. Notwithstanding per capita/acreage ratios, this is a phenomenal resource and appears to raise a question as to why, unlike elsewhere in the Bank for some decades, there is no specialist irrigation division for Africa. To highlight the point further, one need note only that a consultant study some 10 years ago identified at the reconnaissance level substantial irrigation potential in over 20 valleys in Ethiopia. I would suggest that any paper on agricultural lending strategies in Africa should deal with the irrigation question in a constructive rather than a dismissive way. (Africa's relatively sparse physical infrastructure is a related issue not taken up in the draft.)

Hybrid Operations

The draft paper places considerable emphasis on the need for so-called "hybrid operations". It does so, however, without making a convincing case largely because the arguments are weak and the Kenyan example used is inappropriate. The suggestion that hybrid operations would solve an apparent problem of structural adjustment conditionality conflicting with the objections of investment projects seems to dodge the serious question of why the Bank is so organized, and the review process so disorganized, that this can happen. The proposal also begs the question of whether any conditionality can be effective so long as management is reluctant to enforce it (usually apparently in deference to preserving the country relationship). In the reorganized Bank with a tighter country focus, it ought to be self evident that any coherent lending strategy should take care of the kind of inconsistency problems which hybrid operations are expected to avoid. A question would remain as to whether under the current arrangement an objective review and quality control system exists to pick up and correct inconsistencies and conflicts between operations.

The one example given in the draft paper to support the need for hybrid operations is the case of Kenya in the early 1980s. Unfortunately, the sequence of structural adjustment operations followed by service and institutional type projects, and presumably then by production projects (which the paper asserts is inappropriate), was an accident resulting from the structural adjustment program being halted prematurely at the Loan Committee level. This was because of the failure of the government to implement important aspects of the program with the apparent acquiescence of Bank staff. Had the structural adjustment series continued, and given adequate complementarity between the SALs and investment project conditionality, the lending program in Kenya would have been little different from the proposed hybrid operations approach. Again, if important conditionality is not enforced, or not enforceable, there seems little to be gained by introducing a new catch-phrase which is likely only to temporarily band-aid the problem. Nonetheless, there may be a case for hybrid operations, but it is not made in the draft.

Field Staff

The draft paper appears to make the case, with varying degrees of conviction in different places, for increased field staff. This is, of course, a very old issue, but even for those in favor of such an approach, the paper provides little supporting evidence. It does not even refer to the effectiveness or otherwise of the agricultural country officers (ACO) who began to be stationed in eastern and southern African countries from two or three years ago. Certainly, a case can be made (and is supported on occasion by OED findings) for more field staff but it is not made by the draft.

Useful Generalizations and Policy Points

The following is a rapidly compiled personal list of common points or generalizations which could be discussed by the paper before the details of strategies for groups of countries or individual countries are treated. The list could also serve as a source for important subjects which are not dealt with in the draft.

- Food security
- Managing the consequences of drought (not an unexpected phenomenon in Africa but a regularly recurring constraint, but one which is habitually a surprise to governments)
- Cash crops versus food crops
- Export strategy
- Incentives (for farmers, agri-business and the bureaucracy)
- Technology (acquisition, development, adaption and introduction)
- Human resource constraints and strategies
- Institutional development (as the paper states, with more emphasis on long-term self-sustainability than on facilitating merely the implementation of Bank operations)
- Resource conservation and management
- Population growth rates and employment strategies

- Agri-business strategy (increasing value-added)

- Financing agricultural development (foreign investment, agricultural credit, domestic resources).

Country Examples

The use in the paper of the Nigerian ADP experience and the Malawi agricultural sector operations as success stories requires comment. With respect to Nigeria, the paper footnotes that criticism of these projects' production performance is no longer valid now that high grain prices have led to substantial grain production increases. This point is irrelevant given particularly that this current profitable production situation is exactly the same as in the 1970s, but in no way impinges on the criticisms of the program made by OED and others. Most of that production response is attributable to the without-project situation and not to project investments and hence does not invalidate earlier comments on the production problems of this program (besides there being other major issues). In the case of Malawi, the comments on the success of the Bank's agricultural sector lending seem to have overlooked more recent adverse comments in the Bank, academic papers and the press on the relative failure of our lending program in agriculture in Malawi to address equity issues and to achieve production impact. The paper generally needs to broaden greatly the range of examples it draws on since these are currently restricted to just a few countries.

Guidelines

In a paper such as this, one useful objective would be to give specific guidelines to staff on some of the more complex issues. Especially such guidelines could usefully draw boundaries to reduce the complexity of the lending strategy issues. Some examples are as follows:

1. Food security--the trade versus storage dispute with respect to what the Bank might finance, and what degree of food self-sufficiency is supportable (purely by economic and financial analysis, or allowing also for national pride and strategic factors)?

2. The small farmer/large farmer balance in investment--are efficient, purely production projects in food-deficit countries acceptable regardless of equity issues?

3. Damage control--where policies are considered not conducive to effective development, to what extent are Bank resources available to limit the adverse impact of such policies, or to finance investments which are worthwhile, in the long run, irrespective of current policies?

4. Regional operations and organizations--should the Bank make a greater attempt to support regional organizations and operations where these deal with problems and constraints common to several countries?

5. Women in agriculture--what projects and components are appropriate to respond to this concern of especial relevance in Africa?

6. Infrastructure--given Africa's generally poor and rundown infrastructure, what special measures and operations are appropriate in agricultural sector operations to make a greater contribution in this area?

7. Commodity issues--can the specific guidelines be developed on the cash crop/food crop issue, and on "surplus commodities".

A.J.B.
9/9/88

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

E-...

DATE: September 8, 1988

TO: Mr. Vinod Dubey, Director, EAS

FROM: F. Stephen O'Brien, Chief Economist, AFR FSOB

EXTENSION: 34637

SUBJECT: Draft Paper Entitled "Strategic Issues for Agricultural Lending in Sub-Saharan Africa"

1. This paper, prepared by PPR and distributed with a memorandum dated August 15, 1988 from Mr. Rajagopalan to Mr. Qureshi, is scheduled to be discussed by the OC on September 14, 1988.

2. The purpose of this memorandum is to call to your attention some of the Africa Region's principal concerns about the scope, substance, and presentation of this report. You may wish to consider these concerns when formulating the agenda for the OC meeting.

Summary Evaluation

3. The third paragraph of Mr. Rajagopalan's cover memorandum gives the impression that insofar as the paper is based upon "a close collaboration" with regional staff, with regional staff having expressed "widespread support" of the study's recommendations, it (the paper) has in effect been endorsed by the Africa Region. This would be a wrong impression. There is much in the paper that is useful and informative. Indeed, much of the paper represents an articulation of what has become more-or-less conventional wisdom with regard to the needs to closely integrate adjustment and project lending, to develop local capabilities to manage programs, and to foster greater borrower commitment to reform programs. But the fact remains that the African Regional Management Team has serious reservations about this paper, on the following grounds:

(i) The paper is not truly a strategy paper. Its focus is upon three important issues, but there are numerous other issues (e.g. commodity price trends, infrastructural bottlenecks, limited market size, research, environment, etc.) of strategic importance that are hardly touched upon. Moreover, the interdependence between macroeconomic and sectoral issues is especially great in Africa, where agriculture accounts for such large shares of output, employment, trade, and revenues. Only a footnote reference is made to the food security paper. The paper's title and introduction may mislead readers into expecting a report of broader scope and vision than is provided.

(ii) Neither the objectives nor the principal audience of the paper are sufficiently clear and consistent. Para. 25 states that the report is "addressed to task managers responsible for defining the broad outlines of country agriculture sector strategies and designing appropriate supportive operations." The provocative

and polemical style is geared to stimulate lively discussions among staff. But a more balanced approach is appropriate to a paper destined for Board discussion. We need not hide from the Board our shortcomings, but this paper would have us wear a hair shirt.

(iii) The diagnosis of the extent, distribution, trends in, and causes of the "underperformance" of agricultural performance in Africa is incomplete and sometimes lacking in analytical rigour. The paper gives the impression that all types of agricultural lending in Africa have underperformed. There are in fact significant differences between loans and countries. This needs to be recognized and the lessons analyzed and implications drawn.

(iv) Some key conclusions and recommendations do not follow from the facts and/or analyses provided. Chapter III purports to demonstrate various "inconsistencies" between adjustment and investment lending and in the policy advice provided with each instrument. But this section tends to confuse tradeoffs and choices that have to be made in the face of scarce resources and multiple objectives (e.g. between raising employment and lowering inflation, encouraging production through fertilizer subsidies and reducing the fiscal deficit, etc.) with true inconsistencies in policy advice. Compromising among multiple policy objectives is not tantamount to providing inconsistent policy advice. The examples in this section do not support the conclusions reached. The recommendations concerning improved sectoral modelling call for more justification and elaboration.

(v) The key recommendation to emphasize hybrid loans is insufficiently supported. The Africa Region is in fact implementing an increasing number of hybrid loans on a case-by-case basis. But the paper does not provide sufficient analytical support for its sweeping recommendations concerning the design and use of this particular instrument. There is no guarantee that hybrids may not represent the worst, rather than the best, of both worlds.

(vi) The paper neglects certain important factors. For example, the critical role of economic and sector work in the formulation of country-specific strategies and lending programs and in the design of projects is a critical omission. Public expenditure reviews are an important instrument through which we seek to forge consistency among macro, sectoral and subsectoral policies and resource allocations, but their role is not mentioned.

(vii) The paper is outdated and incomplete in that it does not recognize the extent to which the Africa Region has in fact taken actions in recent years to ensure better consistency and complementarity between adjustment and investment operations, to generate borrower commitment, and to emphasize institution building. The paper concludes (para 111) that "much of what is being done ... is inconsistent" with the prescriptions for improving our interventions in these areas. This conclusion is both wrong and unsubstantiated.

4. The Regional Management has in fact recognized our past failures in building borrower commitment and local institutions and capabilities, and we have for several years been emphasizing these areas. We appreciate that we have much to learn about how to operate more effectively in these areas. Unfortunately, the paper does not provide much in the way of new insights or analyses relating to how we could and should do a better and more cost-effective job in these areas.

Where do we go from here?

5. Insofar as the paper is intended to go to the Board, it will be important to ensure that its analytical underpinings are strengthened and its presentation made more balanced and less polemical. The OC may however wish to consider various alternatives for the further processing and distribution of the paper. In the event that it is decided that a revised paper should be presented to the Board, we recommend that the present paper be recast in the form of an informal discussion paper for a Board seminar (as distinguished from a Board Meeting). In this event, the Africa Region would propose to prepare and submit to the Board at the same time a short complementary paper describing our current approach to agricultural lending in SSA, and summarizing our own reflections on the strategic issues involved. These steps would require some delay in the present schedule for Board circulation.

Attachments

As suggested by EAS, we have attached to this memorandum a selected set of comments on the paper. These comments provide numerous examples of problems with the paper, as summarized above in para. 3 (i) - (vii).

RPArmstrong:jas

Cleared with & cc: RMT

cc: Messrs. Ray, Peberdy

Attachments:

August 26, 1988

Ms. Michele Guerard:

Board Paper on Agricultural Lending in SSA

1. Thank you for sending me a copy of this paper. As you suggested I focussed on Section III which is concerned with "the degree to which policy reforms carried out under programs of adjustment are consistent with the policy and institutional requirements of other lending operations" (para. 48). The objective of the section is to establish that inconsistencies have occurred in the past and that therefore hybrid operations should be encouraged. I do not think the paper makes a very persuasive case partly but not totally because of an inappropriate selection of examples. I elaborate on this point below. I also felt that the paper should have paid much more attention to PERs which seem to me to be the most crucial point at which macro and sector concerns converge in a single policy instrument. I offer some thoughts on this point.

2. My comments on Section III are confined to the part entitled "Inconsistencies Between Adjustment and Investment Lending". I will comment briefly on the examples in each of the three subsections.

Institutional Interventions

3. The only example provided in this section concerns the abolition of the Nigerian Cocoa Marketing Board. It is pointed out that this led to short-run problems of loss of quality (even though cocoa farmers almost certainly benefitted). Presumably, the point that the author wants to make is that an element of the adjustment program -- the abolition of the marketing board -- was in conflict with agricultural objectives associated with investment operations. In fact, the Bank had no role whatsoever in the decision to abolish the board. It was certainly not a condition of the Bank's adjustment loan. It is not correct, therefore, to use this as an example of an inconsistency between adjustment and investment lending. Unfortunately, the text leaves the reader with precisely this impression. Since this is the only example provided, empirical support for the inconsistency argument is totally lacking.

Pricing and Subsidy Policy

4. The discussion of cocoa pricing in Ghana correctly identifies a policy dilemma -- on the one hand, increases in the price of cocoa are desired to encourage production, but, on the other hand, government's fiscal requirements must be met. Identification of such a dilemma, however, does not constitute evidence of inconsistency between adjustment and investment operations. In fact, in this particular case, there has been agreement between project staff and country economists on the most appropriate approach and this has been reflected in the recent Cocoa Project and SAC I. The point should be made, therefore, that in this case a hybrid operation was not necessary to achieve a coordinated approach. Again, the example is not well chosen to make the desired point.

Nevertheless, the reader would infer from the presentation that adjustment and investment operations were indeed in conflict.

5. Box 4 on Nigeria raises questions of fact and logic. As far as I am aware a "twenty-fold" increase in input prices was never a part of the adjustment operation. It is true that the farmgate price of fertilizer was increased about 15 percent in 1986 but because of movements in the Naira the rate of subsidy almost doubled. Moreover, the argument that self-sufficiency had been achieved in 1986 but was then threatened by the decline in prices in 1986 needs to be reexamined -- prices were low precisely because harvests were so good.

6. While I am less familiar with the other examples in this section, they still raise questions in my mind. For instance, the discussion of the Tanzanian Tea Authority (TTA) implies that pricing policy introduced as part of an adjustment credit was inconsistent with project goals relating to the operations of TTA because the "trend in producer prices bore no relation to the trend in world prices". The immediately following sentences, however, note that world prices declined by 13 percent and real producer prices by 15 percent which suggests a remarkably close relation. This may, indeed, be a good example of inconsistency but if so it needs to be explained much more clearly. Again the Malawi example presented in Box 3 is an illustration of how conflicts can be avoided without employing hybrid loans.

Public Finance Issues

7. This subsection makes a potentially important point -- namely, that concern with budget-reduction has not been balanced by budget-switching measures. However, while the extent of budget reduction is reported, no effort is made to demonstrate the scope for budget-switching. Certainly, agriculture may have been short of funds, but was it more severely constrained than health, education, infrastructure, etc? The argument as presented is certainly plausible but not convincing. It needs to be placed in a broader macroeconomic context.

PERs

8. The last-mentioned point leads directly to my observation on the role of PERs. Let me use Ghana as an illustration. A PER process has been in place for three years. But the value of the review process is limited by the quality of ministerial submissions, agriculture being one of the weakest ministries in this respect. To remedy this situation, our program of ESW is geared towards developing a medium-term expenditure program based on an explicit sectoral strategy for agriculture. This in turn could become the basis of an operation in which we finance a time-slice of the agricultural expenditure program. But, in doing this, trade-offs with other sectors must be clearly recognized. For this purpose we intend to retain reviews of the overall expenditure program as an important part of our macro adjustment operations. It seems to me that this combination of intersectoral and intrasectoral review is required to come to grips with

the problem of expenditure reduction and expenditure switching noted above. I do not see how the proposed hybrid operations with their subsectoral focus would allow one to address this issue even though this particular problem was mentioned as one of the arguments for moving to such loans.

Lyn Squire

Lyn Squire

Mr. Armstrong:

Re: Strategic Issues for Agricultural Lending in Sub-Saharan Africa

1. Pursuant to Michele Guerard's memo of August 23 and John Peberdy's EM of yesterday, the following is to give you some broad brush comments on the above-mentioned paper.

The paper, as it stands, indicates that investments in agriculture have had disappointing results, and its recommendations stem largely from the premise that this has been the result of inappropriate design and institutional arrangements. The paper accordingly focuses much on instrumentalities, rather than programs/projects content per se. As the form of operations should be patterned after the problems that we are trying to address, there is precious little one can say about the paper's proposals. However, in the absence of any corroborating evidence, one wonders whether the problem may not be somewhat more fundamental--namely, whether past operations were built on assumptions (particularly the required policy environment) that, in retrospect, were inappropriate. One would think that in a sector and continent as complex as this, one would need a thorough and detailed understanding of the workings and economics affecting the sector, which oftentimes is unavailable, in order to be equipped to trace a path through the issues that stand in the way of agricultural development. To this end, we may have to sharpen the focus and internal rigor of sector analysis to identify and "size up" the extent of the issues that need to be overcome, and determine a course of action that will suitably synchronize macro and micro concerns in the sector. The authors of the paper may wish to give some guidance on the type of sector analysis that will be needed to appropriately address sector concerns.

2. This leads to a broader issue, namely, the need to develop the appropriate balance in agricultural, industrial and other sector policies, so that they reinforce each other and contribute to sustained economic growth. There is at present a significant vacuum between macro and sector analysis that needs to be filled. More analytical and empirical work is needed on the relationship between agricultural, industrial and trade policies, and how this affects the internal terms of trade. A good beginning has been done in a few countries, but we need much more attention to the subject to appropriately address policy concerns that affect agriculture through macroeconomic actions and policies in other sectors. It seems to me that in the absence of systematic analysis of the sort suggested above, the approach outlined by A. Churchill (his memo to Mr. Vyas of August 19) makes good intuitive sense.

3. In this respect, the paper seems to get lost in tracing the effects of adjustment policies and changes in relative prices in the agricultural sector. As a result, the paper draws a number of conclusions about the impact of adjustment that are questionable in light of empirical analyses. It asserts, for instance, that efforts under adjustment programs to improve price incentives to farmers and to align these more closely to opportunity costs have at best been ineffective and at worst counterproductive. Indeed, it argues (para. 65) that policy reforms result in the short-run in "economic destabilization" in the absence of capacity to respond. It thus suggests that prior actions are needed on non-price factors (i.e., technological change,

institutional development, infrastructure, etc.). However, empirical evidence (among others, Balassa's recent PPR working paper on incentives policy and agriculture performance in SSA) point to the conclusion that farmers' output and incomes are strongly responsive even in the short-run to price incentives. Moreover, given resource constraints and weak organization--especially in the public sector--the non-price related measures will take some time to implement and will require income improvements and adequate price incentives to finance them, and for farmers to want to take advantage of them. For these reasons, it seems to me that the conclusion to be drawn is that macro and agricultural pricing policy reforms are necessary but, of course, not sufficient conditions for longer term efficient and equitable agricultural growth. Clearly, the non-price related "production shifters" are important when seen in this context.

4. The paper also draws the conclusion that adjustment programs have financially weakened parastatal marketing organizations but that the private sector is not able to effectively take over produce marketing. At the same time the paper neglects to mention anywhere the cost and inefficiency problems which have plagued agricultural (and other) parastatals in much of SSA or the numerous instances where private marketing arrangements are more effective. In any event, a more sophisticated approach could be considered in places where private sector is unlikely to fill the vacuum of official marketing boards by appropriately phasing the reform program to a retrenchment of public entities to a "buyer of last resort role". Whatever options one might consider, a more balanced presentation in this area is needed as well.

5. Finally, the absence of practical additions to the way we have oriented our lending to the sector is painfully apparent. This, from all that I know, may be the only way we can approach the subject given the above-mentioned state of knowledge. At the same time, this tells us something about the process of conception and execution of agricultural projects. A crucial problem in strategy, from what one can infer in the report (i.e., the number of projects that had to be cancelled when external conditions changed) seems to be those of execution and continuous adaptation: getting projects executed, amended, and staying flexible to rapidly changing conditions. To a very large extent, this means going beyond strategy to issues of project conception, organization, structure and the like. So the problem of strategy in agriculture threatens to prove distressingly circular, and one may have to recognize that there are limits as to how much of a strategy can be devised in the present circumstances. Perhaps, until we get a better fix of underlying macro and sectoral problems, we may need to establish a process that allows for greater adaptability--while being more modest for the time being on questions of "strategy" for agricultural lending.

6. In sum, this paper is not ready for Board presentation.

Miguel Schloss
September 1, 1988

cc: Messrs. Wyss o/r
Peberdy

Mr Armstrong

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 1, 1988

TO: Mr. Paul Isenman, Director, AF3DR

FROM: Jan Weijenberg, Acting Chief, AF3AG

EXTENSION: 34409

SUBJECT: Strategic Issues for Agricultural Lending in Sub-Saharan Africa (Board Paper on Agricultural Lending in SSA)

1. At your request I reviewed the above document. My first reaction was that it is a well-presented and thorough piece of work. Based on the review of Bank lending to the agricultural sector in SSA in the 1970s, the authors state that the high failure rates are due to: "inappropriate design, inappropriate institutional arrangements and a general downturn in the world economic environment". They continue to point out that the shift from directly productive investments towards adjustment lending and strengthening services in the 1980s has so far not led to improvement in performance. The conclusion of the paper is that a greater use should be made of "hybrid" loans combining adjustment, program investment, and institutional development with a strong emphasis on borrower commitment. So far, so good! Without going into detail and risking to repeat the authors' paper, I cannot detect major flaws in their reasoning.

2. However, in re-reading the paper, I have a number of concerns, which were reinforced by reading Churchill's comments of August 19. First, the reasoning and conclusions of the paper are entirely based on the analysis of internal reviews (including OED's) of past Bank experiences, while important lessons could be learned from historical agricultural developments in the western world and Asia since the last century (a point made by Churchill). Second, the paper emphasizes for the investment component of the proposed hybrid loans: research, extension, training, input supply and in particular institutional development. In other words, the same components that were included in traditional Bank lending through rural development and area development projects. Now, more through program lending and national projects--which certainly is an improvement--but not much has changed in substance.

3. I guess that the reason that I am not comfortable with the paper's contents, is the lack of depth in the analysis on the investment side of the proposed hybrid loans. The paper mentions twice the absence of (locally proven) production technology, but fails to analyze the reasons and draw conclusions. The paper mentions problems with marketing of both agricultural produce and necessary inputs, but fails to analyze why, or even to mention the possibility of a chronic lack of liquidity in the small trade sector and among farmers. Nowhere in the paper is any mention made of the quality and capacity of the agricultural education system. Training is mentioned frequently but this should not be seen as a substitute for sound formal education. These are only a few examples, but in my view so fundamental that answers (even though in some cases tentative) could easily change the thrust of the paper which is after all presented to the Board as a major change in strategy. In talking to colleagues in other divisions in

the region, I have noticed the same discomfort. I am afraid that agricultural staff in SODs and TD in the Region may have difficulty in identifying with the paper's conclusions. This may in part be due to their lack of involvement in its conceptualization (reviewing with short deadlines is no substitute).

4. One last comment. Much of our approach in the agricultural sector has been supply-driven. In other words, if the economic environment mainly prices) is correct, we have an adequate technical package and we improve the delivery system (both of the package and the necessary inputs), production increases will follow automatically. I have the impression that this approach still prevails in the design of projects in the agricultural sector in SSA. Agricultural support systems that evolved in the western world and to a somewhat lesser extent in Latin America and Asia were far more demand-driven, i.e., responding to real and realistic demands from the farming community. I realize that this may require a very fundamental change in approach towards SSA's agricultural problems, both within the Bank and with our borrowers.

5. I hope that I did not paint too bleak a picture, because I am also convinced that there are a number of "sure bets"--investments that are urgently needed and do not carry great risks. I mention a few: research, agricultural education and land development (irrigation, erosion control, water harvesting).

6. One last point. Despite our reorganization, there are still important cross-sectoral topics for which nobody is clearly responsible (accountable). To mention a few: agricultural education, rural trade, rural financial institutions. I realize that this is a reflection of the real world: the same is true for our clients. But nevertheless, these areas are of such crucial importance that we risk missing the boat due to institutional constraints.

7. Can we discuss?

JWeijenberg:veo

cc: Messrs. Otten (o/r), Pickering, Peberdy, Ali, Steeds, Cleaver,
Seth, Shivakumar, Gorjestani, Penalver, Blanc, Colliou
Sarbib, Armstrong, AF3AG Staff

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 12, 1988

TO: Vijay S. Vyas, AGRDR

FROM: Robert Armstrong, AFRCE RA

EXTENSION: 34585

SUBJECT: Comments on "Design of Agricultural Projects in Africa" Study *

1. Mr. O'Brien asked me to comment on this paper on his behalf. The following are my comments of a general nature. My comments on particular points are provided in the margins of the attached copy of the draft.

2. There are a number of things that I like about the draft, including its readability and the good sense characterizing the judgments and recommendations presented in Sections IV and V. I must confess, however, that I came away from reading the paper as a whole with a sense of puzzlement as to its real purpose and audience, and it wasn't clear to me what new ground it was intended to break or new synthesis to provide.

3. The title leads one to expect an issues paper that will identify problems and to some extent provide diagnoses and suggest solutions. The first paragraph of the Introduction leads the reader to believe that the main problem to be assessed is the "widely shared concern among Bank staff that existing operational procedures are no longer adequate to implement the Bank's newly emerging lending program." Yet at the end of the day, it's not very clear which procedures the authors think are most inadequate and why, nor does the paper prescribe alternative procedures.

4. Then paragraph 3 of the Introduction argues that getting the prices right is not a sufficient condition for accelerated and sustained agricultural growth in Africa, and that "issues relating to project design should [therefore] remain an important concern of Bank staff." Is there really a battle to be waged on this front? Is this the central theme of the paper? That what is important is being overridden by what is (merely) urgent? That long-term issues are being neglected in favor of short-term issues? Whatever the central aim(s) and theme(s) of the paper, they should be better articulated in the Introduction.

5. Section II is essentially descriptive and seems too long. The conclusions arrived at in paragraphs 18 and 19 are not based upon the preceding materials. I disagree with the conclusion that "the major factors affecting the success and sustainability of agricultural projects in SSA have not changed significantly." In quite a number of SSA countries there have been substantial reforms and rationalizations of macro and sectoral policy frameworks. While these have not given rise to large supply responses, one cannot on that evidence conclude that these are not "major factors" affecting project success. On the other hand, is there really any anyone who needs to be persuaded that output and productivity performance is not constrained by institutional bottlenecks, investment

* Note: This pertains to an early draft of the paper, but I think that a number of these comments continue to apply to the draft dated Aug. 15, 1988.

contraction and technological limitations? What's really at issue here? One get the sense that the authors believe that adjustment lending has too much crowded out project lending, and that now the balance ought to be more restored in favor of project lending. But the paper doesn't come out and conclude this explicitly. I for one would like to see these issues joined more directly as long-term strategic rather than procedural matters.

6. The last sentence of para 19 states that "the impact of adjustment [is being] constrained by inconsistencies between the types of policy reforms commonly associated with adjustment and the "policy and institutional basis of traditional project investment." On its face, this is a strong, provocative and important statement/conclusion. What is really being argued in Section III, however, is not a real inconsistency between types of policy reforms as advocated by the sponsors of adjustment vs. investment operations, but rather the inevitable conflicts that arise as scarce resources are confronted by large needs and strong wants. What's really inconsistent here? Our behavior and policy advice? The examples rather have to do with reconciling multiple objectives -- the quintessential economic problem -- than with the need to correct our own irrational behavior. Hence I fail to draw the lessons for how to improve our design of either adjustment or traditional operations, or how the balance should be struck.

7. On the matter of improving the complementarity of policy-related and project lending, I can't imagine anyone taking issue with the conclusions underlined in paras. 34 and 40. But what, then, are we doing wrong or not so well, and who should do what differently, or change his unit's work program in which ways, to ensure that we will do a better job of strategy and project design in future? I imagine that most readers will agree with the call for for more and better sector modelling, but the recommendation in para 40 would be more useful if it were made much more specific.

8. As I noted above, I largely agree with the main points of Sections IV and V (separation of TA training and operational support functions, putting more emphasis on getting internalization/indigenization of the project and policy cycles (which indicates taking a long-term view), the process as our most important product, building collaboration through action planning and project launch workshops, etc. I was really struck, however, at the argumentative tone of some of this, e.g. the last sentence of para 47. The paper would get a better reception and be more useful if it were to concentrate more on providing constructive advice, e.g. on how to change our own incentive systems to get better institution building with a long-term perspective, how to bring the insights of non-economist social scientists to bear in the policy/project design process, etc. What are some of these areas and the lessons of their experience?

Attachment

cc(w/o attachment): Messrs. O'Brien, Peberdy, Pickering, Steeds

RArmstrong:ma

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

8/22 Mr Jaycox FYI

Mr O'Brien cc RMT FYI

cc: Armstrong

DATE: August 19, 1988

TO: Vijay S. Vyas, AGRDR

FROM: A. Churchill, IENDR achh

RE: Strategic Issues for Agricultural Lending

This is an interesting and informative paper and would appear to accurately summarize the state of the debate with the Bank on the issues associated with agricultural lending in Africa.

The general thrust of the paper is that what needs to be done is to improve what we have been doing. The list on page seven of things requiring greater attention, for example, applies to all sectors and has been discussed for many years. The facts are that resources, particularly staff resources, are constrained and even with the best will in the world it is unlikely that resources will be forthcoming in anything like adequate amounts to launch the type of staff-intensive operations implied by the paper.

But I wonder if it is enough. It is intelligible only to someone well versed in the ways and jargon of the Bank. Its messages are often obscure enough to raise doubts about its view of reality. I suspect most African policy makers would have no idea of the meaning of ..."Still pressing is the need to develop sector models that integrate investment-induced supply shifts with policy-induced changes in capacity use", (page 4).

If anything is to be done about the depressing state of Africa, and agriculture in particular, perhaps we need to think in terms of more radical paradigms for solving the problems. The vision contained in the paper is too narrow and may not be up to the task.

The main problem of African agriculture today is the very limited size of the market. Nationalism, tribalism, and other "isms" have further contributed to this. In order to overcome this problem strategies are required that link markets, lower risks, and permit a greater degree of regional specialization. It requires a vision of Africa as a continent, not a set of marginal nation states.

It might be instructive to review the development of the North American continent in the 18th and 19th centuries (and earlier) for some insights into the type of strategies that would be required. After all the early settlers experienced some of the same problems of finding the right crops and the technology of the day was probably more primitive than those prevailing in much of Africa.

Yields were low - increasing yields are a phenomena of the 20th century. Literacy rates are higher today in the developing world than North America in 1800, and little existed in the way of supportive public institutions.

The main problem experienced by these early settlers was the limited size of the market. High shipping costs virtually excluded them from the markets of Europe and the poor state of infrastructure, combined with low incomes, limited the extent of the domestic market. Add to this problem the illiteracy and the poor state of health of the bulk of the population, you have a situation not uncommon in Africa today.

In the case of North America, the story of development is one of overcoming the limitations of the market through investments in infrastructure, changes in technology (particularly in transport), and political unification. Public institutions and public policy supporting agriculture were almost non existent. For agriculture this widening of the market permitted regional specialization -eg. grain in the Great Lakes Region, tobacco in the South, etc. It was this specialization that permitted incomes to grow, not increased yields.

In Africa we are trying to move too fast in the wrong direction. We are trying to circumvent the limitations of the market by going directly into improving yields, institutions, and human capital. In the North American experience, many of these factors followed the expansion of the markets and the resultant growth in incomes. In Africa we are trying to make peasant farmers marginally more productive instead of trying to make them commercial farmers. It does not appear to be working. In addition, the emphasis on public institutions has strengthened the role of governments which have a predilection to limit markets in order to exercise greater control.

What are the alternatives? To some extent many of the policy and investment interventions of the Bank can be seen as market broadening. Certainly improving links to international markets through appropriate exchange and trade policies is important. Investments in human capital and infrastructure also seem to have a high payoff. But is it enough? Is it possible to have a sharper sense of priorities, or a more strategic focus to our interventions? Should we make the expansion of markets and consequently greater regional specialization a focus of our strategy?

Such a strategic focus would suggest a number of interventions, many of them beyond the scope of what we consider typical agricultural sector activities. Transport and communications investments have an obvious central position. The deterioration of the road systems in Africa ought to be a central concern. The road costs are a relatively small part of total transport costs (typically under 15%) with the bulk of the costs accounted for by the vehicle costs. Yet poor roads can have a multiple effect on vehicle costs. Investments in maintaining roads must have a high payoff. It probably pays to reconstruct them even if they do not get maintained. African port costs are among the highest in the world. As long as large rents are collected at the ports African nations will be unable to compete with the rest of the world and severe limitations are placed on the development of interregional trade in the high bulk low value commodities typical of agriculture. Why are our transport investments in Africa so low?

Technology has resulted in dramatic declines in communications costs. (Imagine what the North American farmer of the 18th century would have done with the telephone, let alone radio or television.) Yet in most African countries it is easier to communicate with the rest of the world than a few miles up river. Communications between countries is next to impossible. Surely massive investments in improved regional communications would help break down some of the political and ethnic barriers that so divide the continent.

To conclude...

The paper is lost in the complexity of the situation - the everything depends on everything else syndrome that tends to paralize action. A workable strategy inevitably means some simplification of reality. Growth in Africa will depend on raising incomes in agriculture which in turn will depend on a set of actions beyond the normal concerns of the agricultural specialist.

We need to cut through the confusion and obfuscation that results from viewing growth and agricultural development from a narrow technical perspective and to develop a broader "vision" that permits us to think in strategic terms. The division of the Bank into technical specialties discourages this type of strategic thinking and places a special responsibilty on senior management to cut across these boundries.

cc: Messrs./Ms. S. Fischer, VPDEC, J. Baneth, IEC, J. Holsen, CEC, K. Piddington, ENV, L. Pouliquen, INU, A. Hamilton, PHR, A. Shakow, SPR, R. Picciotto, PBD, Petit, AGR, Rajagopalan, VPPRE

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: August 31, 1988

TO: Mr. Robert P. Armstrong, Economic Adviser, AFRVP

FROM: Isabelle Girardot-Berg, Acting Chief AF1AG

EXTENSION: 34593

SUBJECT: Board Paper on Strategic Issues for Agricultural Lending in Sub-Saharan Africa

Our Division commented on an earlier version of the paper which did not differ significantly from the latest draft (see attached memo from Cleaver to Serageldin of June 21, 1988). We had no particular objection to its contents, and found in it some good advice. At the same time, we felt that it offered little new in terms of substantive answers to the most fundamental aspects of our work. This is because the paper, and especially its recommendations, mostly concentrate on internal processes.

A paper which concentrates on processes and which is going to the Board at this point in time owes it to the Bank Staff to alert our shareholders to the near impossibility of our mandate. Operational task managers are called upon to cover ever more comprehensively the development spectrum by thoroughly integrating institutional, social and environmental factors besides the more traditional technical, financial and economic ones, but with increasingly less staff input and administrative budget per task. As an example, our divisional travel budget only allows two four-week trips per staff per year. Are we going to become more relevant to the problems of Africa by keeping staff at headquarters for want of travel budget?

cc: M. Palein, D. Singh, J. Peberdy, K. Cleaver o/r.

Attachment

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 21, 1988

TO: Mr. Ismaïl Serageldin, Director, AF1

FROM: Kevin Cleaver, Division Chief, AF1AG

EXTENSION: 34595

SUBJECT: "Strategic Issues for Agricultural Lending in Sub-Saharan Africa" - Paper Prepared by AGR, June 14, 1988

1. You indicated that the above referenced paper is of considerable interest, and asked what we are doing to address the issues identified in it. I have circulated the paper in the Department. In answering your question, it is useful to summarize the main themes of the report.

The "Strategic Issues" facing agricultural lending in Sub-Saharan Africa.

2. The report observes that agricultural growth and agricultural project performance have been disappointing in Sub-Saharan Africa (SSA). More than one-half of Bank agricultural projects in SSA have been failures. The following are cited as the strategic issues which are the cause for this poor performance (listed below without discussion):

a) Adverse movement of terms of trade against African agriculture.

b) Poor domestic price policy in many African countries, often leading to excessive taxation of farmers.

c) Absence of agricultural aid coordination.

d) Faulty project design. Projects have been too complex, insufficient local resources have been available to implement them, unsuitable agricultural technologies have been introduced, institution building has been ignored, beneficiaries involvement has been neglected, foreign technical assistance has failed to develop human resources.

e) Inadequate rural infrastructure.

f) Inadequate human resource development.

g) Rapid population growth.

h) Environmental deterioration.

i) Inadequate borrower commitment.

j) Excessively rapid public sector expansion, crowding out the private sector, and consuming excessive resources.

3. The above list is nicely described in the paper, and represents a good summary of what we have been saying for the past year (i.e. there is little new here). Indeed one could add other constraints such as the absence of land tenure security, poor agro-climatic conditions for agriculture in many SSA countries. The emphasis of the report is, however, interesting. It puts much greater emphasis on inadequate borrower commitment to agriculture development coupled with lack of sufficient attention by donors to institution building, to human resource development in agriculture and to proper project design. The report also emphasizes the importance of technological innovation and environmental concerns. Much less emphasis is put in the report than is usually the case on agricultural prices. My own view is sympathetic to the relative emphasis given to the various issues in the report. This is important in answering your question: What are we doing about the issues raised. The entire AF1 agricultural strategy has been based on a perception of the evolution of the problems facing agriculture in AF1 countries which comes very close to that described in the report (see my memo on an agricultural strategy for AF1 countries produced in October 1987).

The Solution

4. The "Strategic Issues ..." report suggests the need to shift the emphasis of our agricultural work. Because the problems are of both a policy nature and due to a lack of productive capacity and technological achievement in agriculture, the emphasis is placed on the careful combination of policy change and investment. It finds that policy changes of the type we are presently seeking in SALs are appropriate, but must be complemented with investment in order to obtain a supply response from agriculture. In addition, the supply response will require the building of sustainable agricultural institution, and human resource development. To do this requires borrower and beneficiary commitment. The paper suggests a radical shift of our assistance into efforts to generate borrower commitment, build institutions and develop human resources in agriculture. It suggests that in terms of lending, we should favor the hybrid policy based investment operation which is most likely to assure linkage between policy change and investment. SALs should be more directed to the overall macro economic and monetary policy framework, as well as resource transfer. The smaller hybrid policy/investment operations would deal with sector policies.

5. "Strategic Issues ..." provides some good advice regarding the ways in which to shift to the above emphasis. The first priority is to generate borrower commitment to policy and investment programs. To do this requires that Government and beneficiaries regard such programs as their own. The process of preparing projects and programs is seen as important as the product, since the process results in either commitment by borrowers or lack of commitment. Generating commitment requires specific effort by the Bank such as the use of workshops in project preparation, posting more staff in the field, ensuring greater continuity of staff with the same borrower, providing training to staff in collaborative project preparation techniques.

6. The second priority is in institution building. The "Strategic Issues ..." report correctly in my view underlines the critical importance of agricultural intensification for Sub-Saharan Africa as populations grow. Population growth will increase the demand for agricultural products. Limitation on area expansion and environmental problems caused by extensive shifting cultivation and extensive pastoral systems will limit this source of satisfying increasing demand for agricultural produce. Hence the need for intensification. The report concludes that agricultural intensification will only occur if institutions which provide agricultural services function. Such services include research, extension, input supply, marketing and credit. They can be private sector enterprises as well as public. To get them to function requires institution building and human resources development. The report argues (correctly to my mind) that we have put too little emphasis on these. The private sector is an important element of agriculture services, and here we have been particularly negligent according to the report. Finally, training of local staff to man institutions is critical.

7. The report emphasizes the need to use and exploit local level knowledge and institutions. Farmer owned and controlled organizations should be assisted.

8. This may all seem to be common sense, but the report points out that much of what we do in Sub-Saharan Africa is not consistent with the above prescriptions. It finds that instead of greater emphasis on agriculture, Bank lending to agriculture is declining. Policy based operations often are not adequately supported by investment operations. Hybrid policy based operations are still unusual in agriculture. Little is done to generate borrower commitment. Institution building is often secondary. The worst of such projects are the area development and the single commodity development projects.

<u>What is AF1 doing</u>

9. The above may sound familiar, and indeed the "Strategic Issues ..." report reads much like our own agricultural strategy paper. Particularly consistent are our agricultural policy prescriptions, the emphasis on linking policy and investment lending (many of our future projects will be hybrids); the development of agricultural services based on building national institutions and on local human resources to manage these institutions, the search for ways to develop the private sector, and our de-emphasis of area development and single commodity development projects. We are also trying to put more Bank staff in the field.

10. The areas which need even more emphasis by AF1 in the coming years, consistent with the recommendations of the report are in:

a) Generating borrower commitment.

b) Training.

Despite our knowledge that generating borrower commitment is fundamentally important, there is still a tendency to prepare projects and policy packages ourselves, or with our consultants. Governments are often regarded at least in part as obstacles to be overcome or convinced. We have sponsored workshops, and there is collaboration. But it is usually not of the full-blown type recommended in the AGR report. This must change. But as the AGR paper points out, generating Government commitment is a staff intensive process, requiring people in the field working closely with Government. One of our new emphases has been on increasing our own staff efficiency. We have done more operations with fewer staff than ever before. (We probably broke some records in FY88). Now that we have cut much if not most of the fat, we might think of re-allocating more staff time to the process of building borrower commitment. In the longer term, as institutions are built with which we can have effective dialogue, commitment will develop in these same institutions. One characteristic of a solid institution is commitment by its staff to its objectives.

11. We have expanded training in our projects. In fact, the training and visit system of extension is directed at training vast numbers of farmers in the field. It is the ultimate weapon in stimulating technical change by the private farming sector. Nevertheless, it is apparent that there is so much training to be done in Africa, that more emphasis should be put on it, and less on technical assistance, in our projects.

Table attached.

KCleaver

cc: Messrs. Wyss, Pickering, Peberdy, Singh, Landell-Mills, Benbrahim, Chapparo, Mbi, Balcet, Katsu, Westebbe, Soto, Rabeharisoa, Dia, Steeds, Otten, Ali, Shrivakumar, Seth, Poortman, Soto, Palein, AF1AG Staff, Africa Center.

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Annex

AF1

Distribution of Agricultural Project Types

	Existing Portfolio 1/		Under Preparation Appraisal 2/	
	Number	(%)	Number	(%)
Food security	0	0	2	6
Nat'l Extension, Research	5	15	9	25
Forestry	3	9	0	0
Forestry/Environment	0	0	7	19
National Livestock	3	9	3	8
Rural Development	13	38	0	0
Export Crop (multi-commodity sector)	0	0	3	8
Single commodity investment (tree crop)	7	21	0	0
Single commodity sector	2	6	1	3
Agro-processing and Private Rural Investment	0	0	3	8
Rural Infrastructure	0	0	2	6
Agr. Sector	0	0	3	8
Agr. Sector Management	1	2	1	3
Fisheries	0	0	2	6
Total	34	100	36	100

1/ Under supervision as of June 1, 1988 (Board approval), excludes technical assistance projects. This excludes the projects which are expected to be brought on to supervision in FY89, and the two technical assistance tasks.

2/ Includes projects in the work program, included in the CAM and the future lending program for which no CAM resources were received.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 8, 1988

TO: Mr. Vinod Dubey, EAS

FROM: Randolph L.P. Harris, CODOP RH

EXTENSION: 73353

SUBJECT: Strategic Issues for Agriculture Lending in Sub-Saharan Africa
Comments on PPR's Draft Report

1. We have two sets of concerns on the above report. The first relates to the comprehensiveness and correctness of the report's analysis of the problems, and the proposed solutions for agricultural lending in Sub-Saharan Africa; the second to the scope and content of the paper before presenting it to the Board.

I. Analysis of Problems and Recommendations

2. The paper states (para 4) that in the 1980s agricultural operations in Africa continued to underperform because:

> "Adjustment programs often were inadequately complemented by investment components.
>
> Institutional development continued to be generally perceived not as a primary development objective but as a tool for satisfactory project implementation.
>
> Borrowers' program planning and preparation functions were based too much on the Bank's internal project cycle."

The summary concludes (para 16) that in view of these problems there are three ingredients which are essential for the Bank's future lending for agriculture in Sub-Saharan Africa: "(1) close integration of adjustment and project lending, (2) a much sharper focus on developing local capabilities to manage programs, and (3) collaborative efforts to develop such programs".

3. The paper does not demonstrate that the three problem areas highlighted were the most significant ones to account for the reported continued underperformance in the 1980s or to what extent they have contributed to this underperformance. Other factors such as the continuing deterioration of infrastructure and environmental degradation, drought, adverse movements in world market prices for agricultural products, and unfavorable policy environment are scarcely mentioned. The rationale for selecting the three problem areas, and their relative importance as strategic issues for agricultural lending in Sub-Saharan Africa should be made clear in the report.

4. The paper does not always clarify to what extent the problems identified have already been addressed through the Bank's reorganization (i.e. the claimed inconsistencies between adjustment and investment lending) or through actions taken by the Region. Details on this should be provided in the paper.

Consistency Between Adjustment and Investment Lending

5. With regard to the individual issues, the report claims that there are important inconsistencies between policy conditions of adjustment loans and the policy and institutional underpinnings of investment loans (see para 48, for example). To remedy this problem, the study suggests to de-emphasize adjustment lending and promote the use of "hybrid" loans with more narrow and modest policy reform. The report does not, however, adequately demonstrate the extent of inconsistencies between adjustment and investment lending, nor does it make a convincing case that "hybrid" loans, are the appropriate remedy. Would the answer not lie in improved coordination at the Country Department level, and has this problem not been appropriately addressed in the Bank's reorganization?

Institutional Development

6. On the second issue, concerning institutional development, the recommendations (para 12) have raised no major queries. The report does not, however, sufficiently examine the extent to which the Region has already been taking important initiatives in this area, and what more they need to do.

Borrower Commitment

7. Regarding the third issue, borrower commitment, the report emphasizes that "insufficient borrower support is one of the most important causes of project failure," and that "the Bank has taken on much of the responsibility for planning, responsibility that should have remained with the borrower" (para 15). It then recommends a more collaborative approach between the Bank and borrower and suggests a number of actions to be taken including more staff intensive field operations and further decentralization of operations review and appraisal procedures within the Bank. The report does not detail the extent to which (a) the lack of borrower commitment and (b) insufficient collaboration between the Bank and borrower are actually problems in agricultural projects in Sub-Saharan Africa.

8. As to the recommendations to improve borrower commitment, the report does not substantiate that they are the most appropriate ones. On decentralization of decision making authority within the

Bank, the paper even cautions that "there are legitimate concerns here about loss of quality control - they should be addressed and a case made that the risks are worth it" (para 101). Should not the study itself analyze such risks before making any recommendations in this area? Also, should field staff be increased beyond the expansion already undertaken or planned by the Region? And what evidence is there about improvements in borrower commitment as a result of additional staff in Bank resident missions? The report should examine this and outline what the Region has been doing thus far on improving borrower commitment.

9. In summary, the report raises some interesting issues, but does not make a convincing case that these were the main reasons for the claimed underperformance of agricultural projects in Africa in the 1980s. It does not highlight the efforts of the Africa Region to deal with these problems, or provide convincing analysis that the recommendations made are the most appropriate and cost effective ones.

II. Scope and Content of Paper for Board Presentation

10. It would seem that considerable additional work needs to be done before the report is ready to be presented to the Board. In any case, the rationale for the paper's scope, be it the three selected issues or others, would need to be provided. It would also be desirable for improvements to be prepared jointly by PPR and the Africa Region.

cc: Messrs. Lee, Casley, Srinivasan (COD)

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 8, 1988

TO: Operations Committee

FROM: Vinod Dubey /V. Dubey

EXTENSION: 78051

SUBJECT: "Strategic Issues for Agricultural Lending in Sub-Saharan Africa" - Agenda

1. The Operations Committee will meet on Wednesday, September 14, 1988 at 4:00 p.m. in Room E-1243, to consider the above-mentioned PPR paper. The paper was initiated in 1986, to draw the lessons from the high failure rate of agricultural projects in Africa. It is currently scheduled for discussion at a Board seminar in December 1988.

2. Although the paper had been discussed with Regional staff at various stages, it still is not an agreed product. This can be seen from the Regional comments attached. The OED, which has recently published parallel reviews of past experience, has also expressed reservations (see attached). The Committee's discussion might focus on a) the comprehensiveness and correctness of the report's analysis and recommendations, and b) the appropriate disposition for the report.

I. Analysis and Recommendations

3. The paper offers a diagnosis of what went wrong with agriculture in Africa, and presents some recommendations to guide Bank operations. It is addressed to "task managers responsible for defining the broad outlines of country agriculture sector strategies and designing appropriate supportive operations (para 25)". "It is hoped that the Bank's Africa Region staff who are directly concerned with operations will be encouraged to design more specific operational guidelines (para 24)".

4. In its view the main problems in the past were due to only three factors: "inconsistencies" between adjustment and investment lending, too narrow a focus for institutional development on project implementation, and inadequate efforts at obtaining borrowers' commitment to projects (para 4). In the light of this diagnosis, the paper recommends much more "hybrid" lending to integrate policy and project concerns (para 9). It also recommends stronger assistance to agricultural support services, greater caution on privatization, and more appropriate forms of technical assistance (para 12); and finally, it offers suggestions on the deployment and training of Bank staff to obtain higher degrees of country commitment to Bank-supported programs (para 15).

Design of Agri Projects Important

trade offs - between
Weakening of
Choices have to be made
Conflict

Adjustment and Investment Lending

5. A central theme of the paper is the alleged inconsistency between policy reforms and investment projects. This theme is developed in Chapter III, which discusses institutional dilemmas, conflicts inherent in reforms of prices and subsidies, and the conflicts between budgetary cuts and budgetary reallocations. This treatment appears to be quite controversial. This may have something to do with the concept of consistency itself as different shades of meaning appear in different places. Is it the inconsistency between multiple objectives that are inevitably involved in all economic decisions, or is it the inconsistency between the advice given to countries by different units within the Region, or is it the inconsistency of the type that occurs when unforeseen changes in relative prices alter last year's priorities? The discussion does imply strong criticisms of the Bank's policy advice although direct evidence is avoided. For example, it is implied that the Bank's attachment to the promotion of competitive private markets and divestments of uneconomic parastatal functions is excessive, and that privatization has been premature and in conflict with the support of parastatals necessary for investment lending. But privatization of the Nigerian Cocoa Board, which is used to illustrate the problems, had nothing to do with the Bank. This and other anomalies are pointed out in some detail in one of the Regional comments. The Committee might consider whether the paper is successful in defining and illustrating consistency issues. It might also consider whether the consistency theme itself is important enough to be emphasized in the paper.

6. The consistency theme leads to the recommendation for increased "hybrid" lending. However, as defined here, hybrid loans would downgrade the policy reform aspect, focussing only on changes that can be defined narrowly in sub-sectoral terms. This diminution of the policy content may not be appropriate since adjustments within agriculture remain of fundamental importance to the structural adjustments of the Sub-Saharan economies. The Committee might consider:

- the appropriateness of weakening the Bank's support for agricultural policy reforms at this time since the structural adjustment processes are far from complete,

- whether the Bank's support for policy reforms can effectively include support for appropriate allocations of public expenditures towards agriculture; if it can then the Bank may be able to maximize its leverage on supply-side measures through public expenditure reviews rather than through hybrid lending,

- whether the pros and cons of hybrid lending have been adequately discussed. Is an intellectual foundation necessary for such lending? Is it at all necessary in this paper to discuss such lending in any detail?

1 research
2 extension
3 secondary advisors

Institutional Development

7. No major issues have been raised on the discussion of institutional issues. However, lest there be any misunderstanding on this score, the Committee might consider whether past and present Regional initiatives have been adequately allowed for.

Borrower Commitment

8. The report emphasizes that "insufficient borrower support is one of the most important causes of project failure," and that "the Bank has taken on much of the responsibility for planning, responsibility that should have remained with the borrower" (para 15). It then recommends a more collaborative approach between the Bank and the borrower and suggests a number of actions to be taken including more staff intensive field operations and further decentralization of operations reviews and appraisal procedures within the Bank. The report does not detail the extent to which the lack of borrower commitment and insufficient collaboration between the Bank and the borrower have actually been problems in agricultural projects in Sub-Saharan Africa.

9. The Committee might consider whether the recommendations on measures to improve borrower commitment have been sufficiently developed. On decentralization of decision-making authority within the Bank, the paper even cautions that "there are legitimate concerns here about loss of quality control - they should be addressed and a case made that the risks are worth it" (para 101). Should not the study itself analyze such risks before making any recommendations in this area? Also, should field staff be increased beyond the expansion already undertaken or planned by the Region? And what evidence is there about improvements in borrower commitment as a result of additional staff in Bank resident missions?

II. Next Steps

10. The PPR might explain the status that it has in mind for the paper and the urgency of going to the Board. In considering the revisions necessary, the Committee might also focus on coverage. In particular, the Committee might consider:

- whether the paper's focus should be confined only to the three selected issues, or whether it should be broadened to include other strategic concerns, such as the food security and environmental initiatives? Should it also cover the lending priorities in complementary rural infrastructure and services (roads, education, etc)?

Para 1.1

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- whether the paper should gear its discussion to the special economic difficulties and circumstances of the Sub-Saharan countries. At present the macro-economic side has not been discussed at all and there is hardly any country specificity. At the present level of generality, the paper probably applies equally well to all countries and all sectors.

Policy loans
are not
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& balance
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- the extent to which the past and present Regional initiatives should be described in the paper.

Attachments

WSchwermer/ARay:eg

cc: Messrs. Lee, Shakow, Holsen, Rao, Burmester/Thahane, Liebenthal, Steer, Baudon, Hopper, Bock, Goldberg, Frank, Parmar, Pfeffermann, Baneth, Tanaka, Robless, Agarwala, Petit, Vyas, Ms. Haug

Policy Mode is not

OFFICE MEMORANDUM

1.

DATE: August 15, 1988

TO: Mr. Moeen A. Qureshi

FROM: V. Rajagopalan VR

EXTENSION: 33419

SUBJECT: **"Strategic Issues for Agricultural Lending in Sub-Saharan Africa"**

1. I attach a copy of the paper on "Strategic Issues for Agricultural Lending in Sub-Saharan Africa" prepared by the Agriculture and Rural Development Department in PPR for your review. This paper has been prepared in response to a Board request prompted by the high failure rate of agricultural projects in Sub-Saharan Africa (SSA) during the early 1980s.

2. After review of project documents and sector reports and discussions with regional staff, members of the study team agreed that the causes of project failure were not limited to deficiencies in project design. Equally important were some of the broader issues of the Bank's agricultural lending program. It was thus decided that the study should address the long-term strategic issues in the Bank's agricultural lending program to SSA. Three issues were singled out for review: the complementarity between adjustment and project lending, institutional development, and borrower commitment.

3. The paper is based on a close collaboration with regional staff. Input from regional staff was solicited at all stages of the study. In June, the Technical Department of the Africa region sponsored a seminar to discuss the findings of the study. Regional staff expressed widespread support for the study's main focus and specific recommendations.

4. I recommend that the paper be circulated to the members of the Operations Committee for their review with a request that any comments that they may have be sent by **September 1st** to Mr. Vijay S. Vyas, AGR, Room J-2261, ext. 37501. The paper is currently scheduled for discussion by the Board in November 1988.

Attachment

cc: Messrs. Michel J. Petit and Vijay S. Vyas (AGR)

VSV:hrv

Draft
For Discussion Only
Do Not Quote

STRATEGIC ISSUES FOR AGRICULTURAL LENDING IN SUB-SAHARAN AFRICA

August 15, 1988

Agriculture and Rural Development Department
The World Bank
Washington, DC

TABLE OF CONTENTS

Executive Summary

1. In response to the favorable circumstances of the early and mid 1970s, the Bank embarked on an unprecendented expansion of its agricultural lending program in Sub-Saharan Africa. The main objective of this invigorated program was to alleviate proverty in rural areas by increasing the productivity of smallholders. To stimulate smallholder output and to reduce rural poverty, most Bank lending between 1974 and 1980 went to directly productive subsectors. Area development projects were the principal vehicles for implementing this strategy.

2. By the late 1970s, there were indications that the new investments to expand output and reduce rural poverty were not yielding their expected benefits. Evaluations showed that investments in African agriculture during the 1970s consistently underperformed the portfolios of all other regions and sectors and failed even to meet the Bank's minimum economic rate of return. The principal reasons for the generally high failure rates were inappropriate design and inappropriate institutional arrangements. These findings, along with the down turn in the world economic environment, forced the Bank to re-evaluate its traditional approach to agricultural lending.

3. As a result of this reevaluation, the Bank began in 1980 to alter its agricultural lending strategy for Africa in four principal directions. First, the Bank reversed its earlier expansion of agricultural lending. Second, it moved away from direct investments in output expansion and poverty alleviation. Third, it gave more support to national institutions that contribute to agricultural productivity. Fourth, it responded to changes in the economic and policy environment and the deficiencies in project design by providing greater support for macro-policy adjustment through structural and sectoral adjustment loans.

4. Despite the shift from directly productive investment toward strengthening services and introducing adjustment lending, there was no sudden improvement in performance. This apparent lack of response to the

new treatment has three main reasons, each related to the Bank's overall lending strategy for agriculture. Agricultural operations in Africa continued to underperform because:

- Adjustment programs often were inadequately complemented by investment components.
- Institutional development continued to be generally perceived not as a primary development objective but as a tool for satisfactory project implementation.
- Borrowers' program planning and preparation functions were based too much on the Bank's internal project cycle.

5. These deficiencies are not unique to the Bank's agricultural programs in Africa. But given the severe constraints facing African agriculture, the deficiencies have particularly serious consequences in the region. Africa generally has less favorable physical resources, more difficult climatic regimes, weaker institutions, less promising technologies, poorer infrastructure, and less skilled human resources than other developing world regions. Moreover, high populations growth rates and mounting land constraints in many parts of the regions are forcing many governments in SSA to seek the far-reaching structural changes in farm technology and rural institutions needed to intensify agricultural production.

Adjustment and Investment Lending

6. Adjustment lending has been marked by a broad array of multi-sectoral actions that run the risk of conflicting with the policy and institutional requirements of investment loans. A related problem stems from confusion about the policy domains that each operation covers. The danger is that with a broad array of activities and conditionalities in adjustment programs, adjustment loans would fall into the same trap as some investment loans: the trap of having too many components without enough regard for their feasibility or appropriateness within particular lending instruments. Thus, in addition to the issue of consistency between the

policy and institutional basis of investment and adjustment loans, a further issue concerns the appropriate blend of policy and project lending.

7. The loan programming "model," that starts with structural adjustment loans and works down to sector adjustment loans and then back to project-based investment loans, has logical appeal. But it is inappropriate for many countries in Africa. A capacity to respond to enhanced economic incentives requires institutional development to help absorb production stimuli in the shortrun. It also requires investments in technology, infrastructure, and education to shift the production possibility frontier outward in the long run. At the same time, however, investment projects require a supportive policy environment. Thus, adjustment and investment lending should be seen as complementary parts of a single assistance package.

8. With the general acceptance of the need to tackle major deficiencies in policies having an economywide impact, the challenge facing the Bank's agricultural lending program is to move toward an agreed sector strategy. That strategy would provide the basis for developing the complementarities and resolving the conflicting objectives of adjustment and investment operations. Decisions on the sequencing and content of various lending instruments are also likely to be better informed if there is clarity on the medium- to long-term sector strategy. Still pressing is the need to develop sector models that integrate investment-induced supply shifts with policy-induced changes in capacity use.

9. Within the framework of an agreed sector strategy, several strategic recommendations for improving the consistency and complementarity of adjustment and investment lending operations can be identified.

- Greater use should be made of "hybrid" loans combining policy-focused adjustment, program-focused investment, and institutional development.

- Hybrid loans should contain elements of program financing (recurrent inputs and maintenance), specific investment (machinery and minor civil works), and training and technical assistance.

- The scope of hybrid lending operations (the policy domain and investment program coverage) should be less comprehensive than today's sector adjustment loans. Financing packages should be devised to focus on policy and institutional reforms and investment programs at the subsectoral level, commodities and lead institutions.
- Hybrid loans should have more modest conditionality attached than current adjustment loans conditionality in areas in which action can be taken at the subsectoral level, thus improving the chances for implementation and monitoring.
- Hybrid loans should be disbursed over two to four years, tranched against clearly defined and easily monitorable targets.

Institutional Development

10. Without a strong institutional structure, the response to both adjustment lending and investment lending can only be weak. This is receiving rather belated recognition by the Bank. One legacy of the old project focus of Bank lending is that institutional development tends to be regarded as a means of ensuring a series of prespecified outputs from projects, rather than something that ensures a flow of inputs to institutions that enables them to produce projects.

11. Institutional development means creating indigenous management capacity. Such capacity involves an ability to plan, implement, and manage projects and programs within an established framework of laws, regulations, and operational responsibilities allocated among public and private entities. As the land frontier continues to shrink in Africa, there is a growing need to switch from a land-extensive system of agricultural production to an intensive system that depends more on the generation and extension of new production technologies. This Agricultural intensification requires strong institutional structures for research, extension, and training -- combined with stronger arrangements for input delivery and output marketing. And central to this effort is institutional support for technological change.

12. The key strategic issues to be addressed under institutional development include:

- Strengthening assistance to agricultural support services, particularly those for the generation and transfer of production technologies. Services must be strengthened from the center outward through strategic time-slice support for line agencies in research, extension, and training.
- Selecting appropriate blends of public, private, and intermediate sectors for each function. The case for full privatization (including cooperatives) will depend on the circumstances of the country or sector and on the nature and function of the institution.
- Selecting appropriate forms of technical assistance -- such as seconding foreign advisers and managers, tapping local sources of expertise, using in-service training programs, and twinning local institutions with better established institutions.

Borrower Commitment

13. Insufficient borrower support is one of the most important causes of project failure. The Bank's approach to project preparation has emphasized the product of this activity rather than the process. Moreover, the Bank has taken on much of the responsibility for planning, responsibility that should have remained with the borrower. This pattern frequently led to a divergence between Bank and borrower interests -- and to poor project performance. The "externalization" of project preparation has been particularly marked in agricultural projects in Africa, ostensibly because of a lack of qualified planners. Agricultural investments need to be carefully adapted to specific physical and cultural environments and usually require the participation of numerous agencies and groups. The need for borrower commitment is even more critical for adjustment lending because of the added political risks and the lack of measurable results.

14. Building or securing borrower commitment depends largely on collaborative planning, a principle that applies to the sector lending program and to its individual operations. The old project-cycle approach

to loan processing -- whereby individual loans proceed through a series of consecutive phases identified and controlled by the Bank -- needs to give way to more flexible procedures that will allow substantially more in-country operations planning by the Bank and its borrowing governments. Once a sector strategy agreement is reached, the execution of its components could move more smoothly from preparation into implementation than is currently done. This emphasis would reduce the danger of losing the borrower's interest and dissipating the multi-agency organizational support mobilized for projects and programs.

15. A collaborative (or joint operations) approach, although already adopted by some Bank staff, is not yet standard practice. Its wider adoption has several important implications for Bank operations. Many of the staffing and operations implications are already reflected in the reorganized Bank, but they still require greater attention. They include:

- Field operations will have to be more staff-intensive.
- Staff will need to be trained in collaborative action techniques.
- Greater continuity will be needed in staff assignment to operations.
- Staff incentives and performance evaluation will have to put greater emphasis on commitment-building as opposed to loan-processing.
- Operations review and approval procedures have to be further decentralized to forge stronger links between joint planning and funding.

* * *

16. To repeat: three essential ingredients of the Bank's lending for agriculture in Sub-Saharan Africa are (1) closer integration of adjustment and project lending, (2) a much sharper focus on developing local capabilities to manage programs, and (3) collaborative efforts to develop such programs. Infusing the Bank's agricultural lending program with these ingredients is urgent because of the importance of that lending in

developing Africa's agriculture -- and the importance of agriculture in Africa's prospects for further development.

I. Introduction

17. Providing development assistance to accelerate agricultural growth and to improve rural living standards in Sub-Saharan Africa (SSA) poses a major challenge to the Bank. The Bank's experience shows that Sub-Saharan Africa and agriculture are the most problematic region-sector combination in Bank investment operations. Evaluation of projects completed during 1979 and 1984 and a review of on-going project performance since then indicate that agriculture has the lowest success rate among all sectors and that Sub-Saharan Africa has the lowest success rate among all regions. While there is some debate over the validity of Bank evaluation criteria, there is little doubt that, despite major investments in Sub-Saharan Africa's agricultural sector, project performance in this sector and region has failed to meet Bank or country expectations.

18. Factors adversely affecting project performance can be divided into four broad categories: (i) unfavorable trends in the economic environment, particularly adverse movements in the international terms of trade; (ii) domestic macroeconomic and sectoral policies that impede project implementation and management; (iii) poor coordination of aid by donors that causes inefficient allocation of resources among projects, unclear administrative procedures, and inconsistent policy directives; and (iv) faulty project design.[1]

19. Issues relating to faulty project design were recently reviewed by the Operations Evaluation Department of the Bank.[2] Some of the project-specific constraints to rural development lending performance identified by OED are: (i) coordination difficulties in integrated multisectoral project

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1/ Both in the sense that even if factors (i) through (iii) were absent, factors internal to the project would have prevented success, and in the sense that an ability to perform well despite factors (i) through (iii) was not designed into the project.

2/ See, "World Bank Experience with Rural Development, 1965-86," The World Bank, OED, Report No. 6883, October 1987 and "OED Report on World Bank Experience with Rural Development: Management Response," The World Bank, AGR, February 17, 1988.

planning and implementation, (ii) the inability of enclave project management units to foster sustainable institutional development, (iii) the lack of beneficiary involvement in project planning and implementation, (iv) the absence of locally proven production technologies, and (v) the failure of foreign technical assistance to strengthen local capabilities. Many of these lessons have been endorsed by the Bank's management and are being incorporated in current investment operations.

20. Constraints to economic growth in SSA, however, go beyond the design of individual projects and are rarely aided by short-term solutions. In most countries in SSA, physical infrastructure is inadequate, human and institutional resources necessary for the varied and complex tasks of economic management are underdeveloped, and rapid population growth hinders broad-based economic development. At the same time, the natural resources needed to support increased population continue to deteriorate in many areas of the region. While the nature of each of these fundamental constraints to agricultural development will vary between countries and even within countries (eg. Central and western Kenya face a more severe land constraint than, say, Zimbabwe, or even other less populous regions of Kenya), they are common enough throughout SSA countries to justify regional generalization.[3]

21. Given the need for both policy-reform and longer-term investments, it, thus, becomes necessary to design an appropriate mix of investment and policy interventions that will stimulate sustainable economic growth. Short-term measures that alter the incentive structure and longer-term investment programs that remove the physical and institutional barriers must be viewed within a sector lending framework. Improved sectoral planning will also serve to strengthen the consistency of objectives and the complementarity of various lending instruments.

3/ A recent AGR paper outlines in detail the distinct physical, institutional and demographic barriers to agricultural growth in SSA. See "Stimulating Agricultural Growth and Rural Development in Sub-Saharan Africa," by Vijay S. Vyas and Dennis Casley, PPR Working Paper, No. 15, June 1988.

22. The removal of these structural constraints requires long-term investments. Rehabilitation of the agricultural sector through policy reform promotes growth in output in the short run. But medium- to long-term growth in agriculture, even in those more favorably endowed countries, depends on a different set of measures. These measures include: building and sustaining an inventory of technology and designing the means to disseminate it; creating an institutional environment conducive to growth; and developing the human resource capabilities necessary to promote and sustain agricultural development.

23. In recent years the Bank has paid increasing attention to the macroeconomic environment in borrowing countries. Support for policy reform and institutional development has become a major part of the Bank's agricultural lending program in SSA and elsewhere. There has been a marked shift from financing discrete investment projects toward support for pervasive policy and institutional reforms. This means that the borrower must be committed to implementing the program of policy reform and institution-building, which, in turn, requires a clear understanding and agreement between the Bank and borrower on the basic principles of the lending strategy. Without borrower commitment, implementation of the lending program can be subverted.

24. There is deep concern among Bank staff over the issues of policy reform, institutional development and borrower commitment. The purpose of this report is to analyze the importance of these issues to the Bank's agricultural lending strategy in SSA. It is hoped that the Bank's Africa Region staff who are directly concerned with operations will be encouraged to design more specific operational guidelines. The first of these issues -- integrating investment and adjustment lending within a sector strategy -- is addressed in Section III. The second issue -- long-term institutional requirements in African agriculture -- is discussed in Section IV. The third issue -- internalizing the preparation and design of lending operations within recipient governments -- is examined in Section V. To put the discussion in historical perspective, Section II provides an

overview of recent changes in the Bank's agricultural lending program. A summary is provided in Section VI.

25. The report is addressed to task managers responsible for defining the broad outlines of country agriculture sector strategies and designing appropriate supportive operations. The study is based on an evaluation of agricultural operations, a review of country economic and sector work and other Bank reports, and extensive discussions with Operations and PPR staff. The study also gained useful insights from research and review initiatives undertaken elsewhere in the Bank, most notably, the AGR report, "Stimulating Agricultural Growth in SSA," the CEC study, "Managing Agricultural Development in Africa," and various OED reviews. The report confines itself to the experiences of Bank lending in the agricultural sector of SSA since the mid-1970s.

III. World Bank Lending for Agricultural Development in Sub-Saharan Africa: An Overview

26. The Bank has been a major provider of external resources to low-income countries in SSA, particularly for the development of their agricultural sectors. Between 1975 and 1984, one-third of total external assistance to African agriculture was provided by the Bank. Changes in the Bank's agricultural lending program thus carry important implications for the development of the sector in a country and, in turn, its economy as a whole. This section outlines changes in the Bank's lending program to African agriculture since the 1970s and the implications of those changes for sectoral performance.

Trends in Lending and Sectoral Performance

27. During the early and mid-1970s, many countries in SSA enjoyed high rates of growth in both output and income: world prices for commodity exports were high, international terms of trade were favorable to agricultural exports, and inflows of external capital helped to maintain

Africa's gross domestic investment rate at a respectable level. In response to these favorable circumstances, the Bank undertook an unprecedented expansion of its agricultural lending program. Between 1974 and 1980, Bank lending for agriculture and rural development (ARD) to SSA grew by an estimated annual growth rate of 10.4% in constant terms and represented nearly one-third of total Bank investments in the region. (Details of Bank ARD lending are provided in Appendix A.)

28. The main objective of the Bank's increased agricultural lending program during this period was to alleviate poverty in rural areas by increasing agricultural productivity in the small farm sector. In an effort to stimulate smallholding output as well as to reduce rural poverty, the major share of Bank lending between 1974 and 1980 was concentrated on directly productive subsectors (90%).[4] Area development projects were the principal vehicles for implementing this strategy. During this period, investments in area development projects in SSA increased by more than 16% a year, representing 40% of all new agricultural loans in the region. (Details on Bank lending for area development are provided in Appendix B.) Other major areas receiving investments designed to expand output and alleviate rural poverty included the food crops, perennial crops, irrigation, livestock, forestry and fishery subsectors. Although area development and other investment projects typically contained provisions for training, research, and institution building, the overriding objective of these investments was to augment agricultural supply by expanding productive capacity and increasing the productivity of the small farm sector.

29. By the late 1970s there were indications that the new investments designed to expand output and reduce rural poverty were not yielding their expected benefits. Subsequent evaluations have shown that investments in

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4/ While a strict separation between directly and indirectly productive investments is difficult to sustain, the term is used here to distinguish between investments that lead to direct increases in output (eg. mainly input supply in farm production) and those which have a secondary effect on output (ie. training, management, infrastructure, social development, etc.)

African agriculture during the 1970s consistently underperformed all other regional and sector portfolios and failed to meet even the minimum economic rate of return established by the Bank.[5] More than half the agricultural investments in SSA audited between 1980 and 1984 (these were largely projects initiated during the 1970s) were determined to be failures, compared to 11% in East Asia, 17% in South Asia and 28% in Latin America. The failure rate for African agricultural investments audited in 1985 and 1986 were 75% and 50%, respectively -- slightly better than the previous years' results, but still well below Bank-wide standards. These results indicate that the majority of Bank investments in African agriculture during the 1970s either failed to achieve an acceptable economic rate of return or, when these rates could not be determined, failed to meet more subjective criteria for project success.[6]

30. There were also some notable successes in agricultural investments in SSA during this period that should not be overlooked. Evaluations show that certain subsectors and country portfolios consistently performed better than others, achieving rates of return above 10%. Credit and forestry investments in East Africa, and credit, irrigation and area development investments in West Africa, audited between 1979 and 1985 achieved average rates of return above 10%. Similarly, certain countries in SSA did well during this period. Projects completed between 1979 and 1985 in Cote d'Ivoire and Burkina Faso achieved 100% success. Malawi, with

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5/ "Annual Review of Project Performance Results, 1985" The World Bank, OED, Reports Nos. 5859, September 1985 and "Annual Review of Project Performance Results, 1986," The World Bank, OED, Report No. 6976, October 1987.

6/ It should be noted, however, that the failure judgement in some cases has proved to be premature since decisions were often based on interim evidence of performance under unfavorable macroeconomic environments. In Nigeria, area development projects that were first criticized as being unsuccessful achieved growth in grain production between 1982 and 1986 of 5% p.a., leading to virtual self-sufficiency in 1986 as price incentives began to improve. During the previous decade, agricultural supply had declined and imports had soared under the influence of overvalued exchange rates when oil revenues peaked. The extent to which some projects judged as failures later turned into good performers when the environment changed is a critical fact that needs to be examined.

an agricultural project success rate of 75%, also had a creditable record. Despite successes in certain sectors and countries, however, the overall performance pattern suggests that SSA has remained the most problematic region for Bank-financed agricultural projects.

Changes in Lending Patterns since 1980

31. Annual reviews of project performance results in SSA have shown that the principal reasons for generally high failure rates were inappropriate design (eg. too complex, insufficient local resources, or unsuitable technology) and inappropriate institutional arrangements. According to OED reviews, 86% of projects audited between 1979 and 1984 were adversely affected by project design and institutional arrangements. Of those projects audited in 1985, all were affected by inappropriate design and 89% by institutional problems. The major secondary causes of unsatisfactory project performance were insufficient borrower support, poor institutional performance, adverse economic conditions, and the disincentive effects of pricing policies. While the 1986 review indicates that investments in some parts of SSA are beginning to benefit from improvements in project design, a more favorable institutional environment and stronger borrower commitment, investments in other parts, most notably East Africa, continue to suffer from technological constraints and inefficient sector policies.

32. At the same time as project performance results for agricultural investments in SSA began to reveal design deficiencies, important changes in the world economic environment also forced the Bank to re-evaluate its traditional approach to agricultural lending. World recession reduced demand and lowered prices for Africa's major exports, international terms of trade moved against the agricultural sector, external resource flows were more constrained, and protectionism and farm subsidies in industrialized countries made it more difficult for African exporters to compete in world markets. These external economic difficulties were aggravated by unfavorable weather during the early 1980s which sharply reduced farm output in many African countries.

33. In addition to these external factors, problems with borrower policies led the Bank to reconsider its approach to agricultural lending. Domestic policies slowed economic growth through exchange rate overvaluation, lax monetary and credit policies, discriminatory taxation of farmers, frequent and indiscriminate use of trade barriers to protect domestic industries, and rapid expansion of the public sector. Macroeconomic and sectoral policies served to transfer resources from agriculture to other sectors of the economy. The disincentive effect of government policies on agriculture was evident in declining and, in some cases, negative growth rates in farm output. The disincentive effects of domestic policies were aggravated even further by the inability of national institutions to provide basic agricultural services to farmers.

34. By 1980 the Bank had begun to respond to deficiencies in project design as well as external economic and domestic policy constraints by altering its agricultural lending strategy to SSA in four principal directions. First, the Bank reversed its earlier expansion of agricultural lending. Growth in new investments in agriculture and rural development in SSA declined in absolute terms at an estimated rate of -3.8% p.a. between 1981 and 1987.[7] While, the rate of expansion of ARD lending has slackened in recent years, total lending levels to SSA have continued to climb. Agriculture received on average one-third of total annual resource flows to SSA before 1981 (with a peak of more than 41% in 1975 and 1977), compared with an annual average of less than one-quarter since 1981. (See Appendix A.) Thus, while ARD lending during the mid to late 1970s experienced a major increase relative to total investments, the sector's share of total lending has been declining since the early 1980s.

35. Second, the decline in ARD lending growth to SSA has been accompanied by a change in the composition of investments in the

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7/ This figure includes funds for agricultural inputs under sector adjustment loans. Still, the level of resources diverted from ARD lending since 1981 is slightly overstated due to the fact that a greater share of funds is now being channelled into structural adjustment programs which, in the case of African countries, generally contain a major agricultural component.

agricultural sector away from direct investments in output expansion and poverty alleviation. Between 1981 and 1986, for example, investments in area development projects fell in absolute terms at an estimated annual rate of -21.7% (in constant dollars). (See Appendix B.) Simiarly, Table 1 below shows that the share of project cost components for objectives other than direct increases in output (eg. agricultural services, institutional development and infrastructure) rose from an average of 46% between 1974 and 1980 to 60% between 1981 and 1986, compared with a fall in the share of project costs invested in more directly productive components such as crops, livestock, forestry and fisheries. The major portion of the former category of project cost components is accounted for by an increase in balance of payments support, used primarily to sustain and augment the supply of imported inputs during periods of sectoral and macroeconomic adjustment.

Table 1

Distribution of Agriculture Lending to SSA by Project Cost Component, 1974-86
(US$ million)

	1974-80			1981-86		
	Total	Annual Average		Total	Annual Average	
COMPONENTS	Amount	Amount	% of Sector	Amount	Amount	% of Sector
Crops	897	128	16.8	1112	185	14.9
Inputs	456	65	8.5	1775	296	23.8
Livestock	334	48	6.2	129	22	1.7
Forestry	160	23	3.0	195	32	2.6
Fishery	17	2	0.3	22	4	0.3
Research/Exten.	364	52	6.8	698	116	9.4
Training	53	8	1.0	209	35	2.8
Management[1]	907	130	16.9	972	162	13.0
Infrastructure	296	42	5.5	371	62	5.0
Irrigation	248	35	4.6	217	36	2.9
Social Devt.	160	23	3.0	229	38	3.1
Credit[2]				6	1	0.1
Contingencies[3]	1463	209	27.3	1519	253	20.4
TOTAL PROJECT	5353	765	100	7453	1242	100

[1] Includes technical assistance.
[2] Most credit investments have been included in other components.
[3] Represents residual costs. Project contingencies generally estimated at 15-20% total project costs.

Source: AGR Data files, The World Bank

36. The third change in the Bank's agricultural lending program in the region since 1980 has been a shift toward greater support for national farm service institutions that contribute to agricultural productivity (ie. agricultural research, extension, forestry, animal health, financial services, input supply, and other agricultural and environmental services). For example, during the seven year period between 1974 and 1980, the Bank devoted 6.8% of its agricultural resources to research and extension (less

than 1% in direct stand-alone project support). Between 1981 and 1986, the share increased to 9.4% (nearly 3% in autonomous project support). Projects under current appraisal indicate that over the next three years the growing level and share of ARD resources invested in research and extension operations in SSA will be maintained.

37. The fourth response by the Bank to changes in the economic and policy environment and project design deficiencies is greater support for macro-policy adjustments. The Bank has two maisn instruments through which it supports adjustment. The first is structural adjustment loans which support broad policy changes and institutional reforms. These reforms aim to achieve efficient use of resources and contribute to a sustainable balance of payments in the medium and long-term while maintaining growth. Structural adjustment loans finance general imports. The second is sector adjustment loans which support policy changes and institutional reform in a specific sector. These loans finance either general imports or parts of a sector investment program. Since 1980 there has been a shift away from investment loans towards structural and sector adjustment loans. Table 2 shows that the average annual share of total resources channeled through specific investment loans in SSA fell from 57% between 1978 and 1982 to 35% between 1983 and 1987, while the share of funds allocated to adjustment lending increased from 7% to 29%.[8]

8/ Lending sums for adjustment represent a totalling of those funds under sector adjustment loans and program lending and SAL instruments shown in Table 2. Program loans, not technically the same as adjustment loans, account for a small share of this amount.

Table 2

IBRD/IDA Commitments to Africa by Lending Instrument, 1978-87 (US$ million)

	1978-82			1983-87		
	Total	Annual Average		Total	Annual Average	
Lending Instrument	Amount	Amount	% of Region	Amount	Amount	% of Region
Specific Investment Loans	4257	851	57	3465	693	35
Sector Adjustment Loans	115	23	2	1669	334	17
Program Lending & SAL	395	79	5	1142	228	12
Sector Investment Loans	1652	330	22	2462	492	25
Financial Intermediary Loans	599	120	8	492	98	5
Technical Assistance Loans	342	68	5	555	111	6
Emergency Reconstruction Loans	73	15	1	119	24	1
Total	7433	1486	100	9904	1981	100

Source: Bank files

38. In addition to these regular funds in support of adjustment, adjustment lending was augmented by the creation of a Special Facility in 1985 designed to provide additional quick-disbursing assistance to IDA-eligible countries in SSA that had undertaken, or were to undertake, medium-term programs of policy reform. More than $1.9 billion has been made available to the Facility for commitments through FY88. Commitments to date equal $1.4 billion. At the end of FY87, disbursements amounted to $604 million, representing an important additional source of adjustment support funds. When funds committed under the Special Facility are included, over one-third of all Bank resources going to Africa since 1983 are in direct support of adjustment.

39. However, adjustment loans are only one way in which the Bank can respond to economic constraints and policy deficiencies. The Bank has a wide range of lending instruments with which it can effect policy change.

While each Bank loan instrument is identified by its own set of objectives, focus and content, use of proceeds, level and scope of conditionality, and period of disbursement, each is increasingly being absorbed into the framework of adjustment lending.

40. To recapitulate, the Bank's agricultural lending program in SSA throughout the 1970s was designed to increase output and income through the introduction of new production technologies, particularly in the small farm sector. Its aim was to increase smallholder productivity. While this project-based investment strategy achieved considerable success in other parts of the world, the strategy failed in many countries in SSA, due to weaknesses in project design and poor external and domestic policy environments. Adjustment lending represents an attempt to deal with these constraints. The objective of adjustment lending is to increase productive efficiency and shift the domestic terms of trade back in favor of agriculture.

41. Despite some improvement in agricultural output in recent years, adjustment lending has had much less success in increasing agricultural productivity in SSA. Part of the stubbornness in performance stems from the inevitable time lag between policy reform and increased production. It also appears that output and productivity performance remains highly constrained by institutional bottlenecks, investment contraction and technological limitations. Important to the successful implementation of these changes is greater consistency and complementarity between adjustment and investment lending, increased support for institution building, and a greater degree of borrower government commitment to implementing the joint agreed lending program of the borrower and the Bank.

IV. Consistency and Complementarity Between Adjustment and Investment Lending

42. All lending instruments include, or have the potential to include, policy conditionality. The difference between them is the specificity or

comprehensiveness of policy reform. For instance, specific investment loans focus on those aspects of the sector policy framework that bear directly on the productivity of those investments. Sector investment and maintenance loans require agreement on the design of sector programs as well as on specific measures to strengthen management and policies and the institutions carrying them out. Technical assistance loans build capacity or institutions directly concerned with sector or economywide policies and strategies. Consistency between the policy foundations of loans is crucial to the success of the country assistance strategy.

Inconsistencies Between Adjustment and Investment Lending

43. While programs differ in comprehensiveness and specificity, most agricultural adjustment loans support policy and institutional reforms. They address, directly or indirectly, five interrelated areas:

- **Reform of pricing policies** to strengthen agricultural producer incentives through raising output prices, eliminating consumer subsidies; phasing out input subsidies, decreasing marketing margins, shifting relative prices in favor of tradeables, and allowing inter-regional producer price differentials.

- **Reform of trade regimes** through liberalization and measures to reduce distortions; to increase the competitiveness of, and resources for, exports; and to promote efficient resource allocation.

- **Reform of fiscal and financial policies** to mobilize resources, particularly through restructuring tax and tariff regimes and rationalizing interest rates.

- **Improvements in the efficiency of domestic resource use** through rationalizing public sector investment programs and reducing government involvement in economic decisions, particularly regarding prices.

- **Institutional reforms** including measures to strengthen budgetary procedures, encourage administrative reform, and build analytic capacity, as well as measures to assist parastatal reform and promote private sector activity.

44. A survey of 36 adjustment loans with agricultural components found that institutional performance and agricultural pricing policy were the two

most frequently addressed issues.[9] As Table 3 illustrates, institutional factors were addressed in all operations initiated in the region since 1980, while nearly all (83%) addressed agricultural pricing and subsidy issues. Foreign exchange and debt management measures featured as conditionality in 56% of the operations; trade related conditions in 44%; credit and banking conditions in 36%; and environmental issues in 8%.

Table 3

Frequency of Occurrence of Conditionality of Agricultural Related Adjustment Loans in Africa by Policy Area, 1980-86

Policy Areas	Number	(%)
Institutional	36	100
Agricultural Pricing	30	83
Foreign Exchange & Debt	20	56
Trade	16	44
Credit & Banking	13	36
Environment	3	8

Source: AGR data files, World Bank.

45. Within institutional reform, a number of specific measures stand out. Nearly two-thirds of all the Africa adjustment operations contained conditionality on public investment program reviews and financial reforms for parastatals. Conditionality aimed at improving the operating efficiency of parastatals occurred in 40% of the operations. Three other specific measures that concern parastatals were each made conditions in one-third of the Africa operations: reduction of their roles in domestic marketing and trade; cost recovery; and divestiture. Reducing the state's role in international trade and marketing was mandated in 22% of the loans.

9/ Ridley, N. and Roberts, C., "Policy Areas and Trends in Adjustment Lending Related to Agriculture, FY79-87," Agriculture and Rural Development Department, The World Bank, unpublished.

Finally, staff reductions in the public sector were required in 19% of the adjustment operations under review.

46. Agricultural pricing issues were also treated extensively in programs of adjustment in SSA. Reducing subsidies was the measure most often called for (44% or 16 operations). Elimination of price controls was included in the conditionality of only six, but 13 other loans required the improvement of price-setting mechanisms. In a number of cases, the focus on the price-setting mechanism was a second-best solution after the Bank failed to persuade a government to abolish its price control system.

47. It is difficult to evaluate the implementation and impact of institutional reform programs under adjustment because of the time required for their completion. Though management of public enterprises has been strengthened in many countries, the process of institutional reform has been slow. Even relatively less complicated institutional development activities, such as financial and management audits of public enterprises, were often difficult to accomplish. The experience with pricing policies has been more positive. Adjustment programs for most countries stipulated that producer prices for key food and export crops be increased to (or near to) their international market equivalents, and that subsidies on fertilizer and other farm inputs be reduced or phased out. Most of these policy changes have been implemented, though in some cases with delay.[10]

48. One of the most important determinants of implementation performance is the degree to which the policy reforms carried out under programs of adjustment are consistent with the policy and institutional requirements of other lending operations.[11] Discussions with operational

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10/ "Structural Adjustment Lending: A First Review of Experience," OED Report No. 6409, September 24, 1986.

11/ Another important factor determining the success of adjustment loans is the extent of conditionality. The different combinations of activities and degrees of conditionality which can be observed among recent adjustment loans with a major agricultural component in SSA suggest that these loans may occasionally be falling into the same trap as area development projects previously fell into, namely, loading the
Continued on next page

staff and review of project documents reveal a number of inconsistencies between the policy conditions of adjustment loans and the policy and institutional underpinnings of investment loans. Inconsistencies between individual loans may be acceptable only if: (1) a clear understanding and agreement with borrowers exists concerning the direction and process of agricultural change; (2) the economic conflicts are of a short duration; and (3) the social costs of living with these short-term trade-offs outweigh the benefits of medium- to long-term investments. Unfortunately, many of the inconsistencies observed in the Bank's agricultural lending program, especially in SSA, do not meet these qualifications. Common inconsistencies between the policy conditions of adjustment and investment operations are discussed below under three headings: institutional interventions, pricing and subsidy issues, and public finance issues. A few examples are provided to illustrate the points.

49. **Institutional Interventions**. A great deal of attention has recently been given to the reform of parastatal institutions and/or substituting private sector enterprises for them. Many of these institutions have been marked by inefficiency and an inability to provide adequate services. Yet parastatals have historically received considerable financing from the Bank. Despite the fact that an increasing emphasis in adjustment lending has been on divestiture and transfer of marketing functions to the private sector, public sector institutions continue to play an important role in agriculture. During this transition period, the tendency of investment lending to support public sector institutions has often been in conflict with the tendency of adjustment lending to strengthen the role of the private sector. In many of these cases, the process of divestiture is undertaken without adequate preparation to deal with the post-restructuring difficulties of market liberalization. (See Box 1.)

Continued from previous page
adjustment package with different types of conditionality beyond the borrower government's ability to realisitically undertake and implement.

Box 1

World Bank Experience with Privatization of the Nigerian Cocoa Marketing Board, 1987

The recent quality problems, and subsequent price discounts, faced by Nigerian exporters of cocoa following the abolition of the Cocoa Board are relevant here. The Nigeria Cocoa Board (NCB) was the beneficiary of earlier Bank assistance whose success was limited due to deficiencies in the macroeconomic environment, particularly the overvalued exchange rate. Following the privatization of NCB, no reliable quality conscious exporters of cocoa emerged so dealers were unable to offer Nigerian cocoa for forward sale. The principal problem was the continuing presence of currency operators prepared to pay internal market prices well in excess of the international market equivalent for cocoa of any quality as a vehicle for transferring funds abroad. Thus, the quality and dependability of Nigerian cocoa exports declined, forcing international customers to look elsewhere for cocoa imports. Addressing the post-market liberalization problems may improve the Bank's experience in other countries in SSA, where a similar emphasis of adjustment on a reduction in parastatal functions and their transfer to the private sector marks a reversal from earlier project assistance to parastatal agencies.

50. A related conflict stemming from marketing reforms carried out under adjustment concerns the rationalization of parastatal budgets. Traditionally high profit margins from the purchase of food crops have enabled parastatals to subsidize other costs, such as consumer prices, fertilizer use and tractor hire schemes. Profits from the marketing of exports have also been used to cross-subsidize national food programs. However, parastatal budget rationalization, coupled with an increase in producer prices and a reduction in government financial support, place marketing boards in a financial "squeeze" and make it difficult for them to continue meeting the costs of their other agricultural service obligations as well as new project investments.

51. While recognition of major inefficiencies in parastatal activities is reflected in the policy orientation towards the private sector, the degree of substitution has been constrained by the nature of the activities and markets in which privatization has been deemed desirable. Such shifts risk premature transfer of activities to private sector agencies that often

lack the financial stability and the expectation of an adequate return on capital to justify investment in those functions previously carried out by parastatals. Rural markets, generally in East African countries, tend to be characterized by major information constraints and imperfections that limit the comprehensiveness of coverage that might otherwise be achieved by a simple reliance on the private sector.

52. <u>Pricing and Subsidy Policy</u>. The second area in which inconsistencies between adjustment and investment lending occur is pricing and subsidy policies. In a number of African economies, emphasis has been placed on reforming domestic price structures. Such reforms focus on shifting relative prices in favor of tradeables, as well as reducing the disincentive effects of discriminatory taxation policies. The approach has been to move domestic prices closer to border price levels in the belief that this will be accompanied by a positive output effect and, through the income gain, a demand side effect. However, as recent experience shows, other factors have to be taken into account. First, output response in SSA is seriously constrained by non-price variables, including investment levels, inadequacies in goods and services delivery, and infrastructure constraints.[12] Second, where possible tax sources are limited and collection costs high, the maintenance of indirect forms of taxation through output pricing has proven necessary.[13] Despite almost five years of real price increases for cocoa growers in Ghana, for example, producers still receive less than 60% of the border price. While this represents a substantial improvement over previous price levels and has resulted in a rise in output passing through official hands, further increases in cocoa prices are constrained by the large share of tax revenue coming from the cocoa export tax.

12/ See, for example, "Stimulating Agricultural Growth and Rural Development in Sub-Saharan Africa," op. cit.

13/ More direct forms of taxation, such as land, property and poll taxes, are being given greater consideration by the Bank and may provide alternative forms of public revenue in the future. Their usefulness in SSA at the present time, however, remains uncertain.

53. Apart from public finance considerations, pricing changes made in association with adjustment lending have implications for the financial viability of marketing agencies and other parastatals. The degree to which higher domestic producer prices can be sustained depends on trends in international commodity prices. In Senegal, for example, recent groundnut producer price increases designed to raise output in the tradeables subsector have necessitated additional subsidies due to the financial squeeze on the parastatal oil milling sector resulting from declining world groundnut prices. This has occurred in a context where reduction in the budget deficit has been a key priority under adjustment. Similarly, the financial viability of Bank investments in the tea industry in Tanzania was undermined by the effort to maintain favorable domestic producer prices in the face of falling export prices. (See Box 2 for an example of how the Bank might help governments more effectively deal with price squeezes.)

Box 2

Producer Pricing Policy and the Financial Viability of the Tanzanian Tea Authority in the 1980s

In 1981 Tanzania received an adjustment credit designed to rehabilitate the country's export sector. During the same year, a specific investment loan aimed at consolidating the operations of the Tanzania Tea Authority (TTA) became effective. TTA is the government parastatal responsible for the overall development of the country's tea industry, including export marketing. Five years after the project became effective, a Bank mission reported that TTA was incurring large financial losses. The mission stated that the trend in producer prices bore no relation to the trend in world prices. Between 1980/81 and 1984/85, the price of green leaf paid to farmers increased by 227% in current terms, compared with a 13% decline in world prices. In real terms, however, producer prices fell by 15%. Despite a decline in real terms, the mission argued that producer prices were financially unsupportable given the level and trend in world prices. To resolve TTA's financial problems, the Bank recommended that a new producer price system be introduced. Under the new system, producers would receive an initial payment fixed by the Government in consultation with TTA, and a second payment which would vary in accordance with TTA's profitability and prices earned from the sale of its tea.

54. Conversely, in an effort to encourage agricultural exports, adjustment programs often require governments to hold down the producer price of certain competing crops. Malawi's National Rural Development Program (NRDP) was launched in the late 1970s with Bank financing to promote the adoption of new production technologies within the smallholder sector. Measures were introduced to increase the productivity of food crop cultivation, particularly maize. The idea was to enable small farmers to shift into the production of export crops without threatening national food security. These goals were latter undermined, however, by the pricing decisions made under the Bank-financed adjustment program in Malawi. Real producer prices for maize have been held constant, fertilizer subsidies have been removed, and producer prices for competing export crops have been raised. As a result, improved seed varieties have not been widely adopted and maize output has not risen significantly since implementation of the NRDP.[14]

55. Moreover, changes in producer pricing policy often conflict with other policy changes carried out under adjustment. This is particularly the case between producer pricing policy and domestic marketing reforms. An increase in production incentives through higher producer prices acts as a deterrent to increased private trading activities if trade margins are not also allowed to rise. This is especially the case when pan-territorial pricing policies and consumer price ceilings exist. A narrow and uniformly applied trade margin deters private traders from assuming responsibility for the buying and selling of crops in areas where transport costs are high. The failure to integrate different marketing costs into producer prices results in private traders out-competing the public sector in those regions that are most profitable, while leaving public marketing agencies responsible for the unprofitable remote areas, thus perpetuating rather than reducing the financial difficulties of marketing parastatals. (Box 3

14/ Non-price factors also contributed to the low adoption rate of modern seed varieties (eg. consumer resistance to the quality of hybrid maize available). However, a favorable price climate would have helped to encourage an improvement in quality through encouraging greater research efforts, as happened earlier in the case of wheat and rice in Asian developing countries.

details an attempt by the Bank to address the adverse effects of Malawi's pan-territorial pricing policy after divesting the trading function of the state-owned parastatal under its adjustment program.)

Box 3

Pricing Policy and Agricultural Marketing Reform in Malawi

A supplemental financing loan for the 1986 Third Structural Adjustment Operation in Malawi focuses on strengthening the role of the private sector, both in agricultural marketing and in the non-marketing activities that the Agricultural Marketing and Development Corporation (ADMARC) will be divesting. Concerned about the adverse effect of the pan-territorial pricing policy on private marketing initiatives, the Bank has recommended that the Government introduce an incentive pricing system to encourage merchants and farmers to undertake some of the assembly and transport functions currently handled by ADMARC. The Government has also agreed that ADMARC's selling price for domestically grown products, including maize, will be set high enough to cover domestic marketing and handling costs. By removing some of the consumer food subsidies, the Government will be both providing a wider trading margin within which private sector traders can operate as well as improving ADMARC's financial position.

56. Potential inconsistencies in output pricing policy reform apply equally to input subsidy policy reform. Investments in rural development during the 1970s designed to diffuse the benefits of agricultural growth among smallholder households and to eliminate rural poverty were largely premised on the provision of modern farm inputs at subsidized prices or through subidized credit. However, the Bank now generally opposes input subsidies on both efficiency and budgetary grounds. Reducing or eliminating fertilizer subsidies has been featured as a policy conditionality in many of the adjustment programs initiated in SSA. In most of these cases, upward input price adjustments have occasioned sharp reductions in input consumption. During the Second Structural Adjustment operation in Malawi, the Government agreed, as mentioned above, to remove fertilizer subsidies for maize provided to small farmers under NRDP. An earlier project report noted that the issue of input cost and delivery, particularly fertilizer supply, was critical to the program's success. By

1984/86, marketed output of maize from the small farm sector to ADMARC had fallen by 50%.

57. It is difficult to determine whether the decline in marketed maize output is due to the removal of fertilizer subsidies or other policy reforms such as the cap on maize producer prices or the increase in producer prices for export crops. Input consumption is determined not by shifts in inputs prices alone, but by relative shifts in input/output prices. In Burkina Faso, fertilizer use increased as subsidies were eliminated, but there was a more than offsetting increase in output price. In Mali, chemical fertilizer use declined slightly as subsidies were eliminated, accompanied by a less than offsetting increase in output prices, but there has been an increase in conservation and use of manure. However, what is clear is that a rapid and unexpected removal of farm input subsidies can result in considerable lost production and suffering for the poor. Farmers take time to adapt their cropping patterns and farming methods to the new prices; there can thus be a sizeable dip in their output and incomes. (See Box 4.)

Box 4

Pricing Policy and National Food Security in Nigeria

The Nigerian experience shows that drastic price changes associated with adjustment can create short-term transitional problems for agricultural production. The Government's food production plan in Nigeria was built on the promotion of a modern input-based technology which was viable financially at the then prevailing input/output prices. However, having achieved food self-sufficiency in 1986, the adjustment program threatens this achievement because with the twenty-fold input price increases called for since the program was launched and the decline in output prices in 1986, the necessary incentives suddenly disappear, undermining the food production strategy. Despite continued increases in commodity price instability, especially for annual food crops, alternative technologies that could permit maintenance of incomes and production have not been developed.

58. The question of input prices is particularly important in the African context, as relatively short-run budgetary imperatives and policy

preferences often conflict with longer-term objectives of raising agricultural productivity. African agriculture remains characterized by relatively low productivity and major technological, as well as climatic, constraints to raising productivity. In many parts of SSA, the demand for yield-enhancing inputs is thin and variable. One consequence is that private sector involvement in such markets continues to be uncertain. Given the importance of credit in expanding the use of modern inputs, particularly among small farmers where effective demand for these inputs is weak, input prices should not be raised, or at least not raised as rapidly as the "free market" would dictate in the short-run. Where intensification of agricultural production is a national priority -- as it is in most SSA countries -- governments may find it necessary to implement targetted input subsidy programs. Thus, while adjustment lending has focused on increasing the role of the private sector, the delivery of key services such as research, extension, credit, input supply and veterinary services will continue to require public sector involvement and flexible pricing and subsidy rules for some time to come.

59. Public Finance Issues. Adjustment lending has been concerned with both mobilization of resources and reducing and restructuring public expenditure. A common object of attention has been budgetary transfers to parastatal organizations and the elimination or reduction of subsidies. In Senegal, for example, there has been a sharp reduction in the operating budgets of the various extension agencies. This has helped the budget deficit measured as a share of GDP to fall from a peak of 10% in 1981/82 to a projected level of 1% in 1987/88. However, this expenditure reduction has not yet been accompanied by sufficient expenditure switching. Across the board reduction in budgetary support for parastatals has resulted in inadequate recurrent expenditure and a collapse in the field efficiency of the extension agencies. Sharp reductions in public expenditure levels unaccompanied by switching have also resulted in an inability to cover the counterpart costs of established projects.

60. Again, the case of the NRDP in Malawi is instructive. The 1982 review of the NRDP reported that implementation of the program had suffered from a lack of government funds for maintaining and operating existing

investments. The review noted that while some of the operating costs of existing NRDP projects were to be funded from the Ministry of Finance's development (ie. donor funded) account, it was uncertain whether sufficient additional recurrent funds would be made available, not only in the current fiscal year, but also in the medium-term. Based on the Government's projections of total recurrent resources and on several other assumptions on allocations to the Ministry of Agriculture (MOA) and comparing these to requirements, the review estimated that the deficits on MOA's recurrent account due to NRDP requirements would increase from MK3.1 million in 1982/83 to MK15.5 million in 1985/86.[15]

61. To reduce the recurrent deficits, the Bank proposed introducing a tax on export crops, placing an excise tax on crops sold domestically, raising consumer prices for crops sold domestically, which would increase ADMARC's surplus, and increasing the rate at which the government taxed ADMARC's profits. The cost of any new tax on agricultural output (whether marketed externally or domestically) would eventually be passed on to the producer and would imply crop farmgate prices lower than those recommended under adjustment, which in turn would reduce farmers' incentives. Cost recovery measures, on the other hand, would weaken ADMARC's financial ability to continue operating its other agricultural support programs.

62. One year after the Bank completed its review of NRDP, a reduction in public spending became a major priority of the budget rationalization program under Malawi's Second Structural Adjustment Operation. The rapid expansion of development projects, most notably the NRDP, meant that the Government's recurrent and development account expenditures outpaced the growth in public revenues. The lack of adequate provision for recurrent operations reduced the benefits originally expected from project investments. Because of the limited scope for additional revenue measures in the medium-term, a reduction of the budget deficit was to be achieved

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15/ A follow-up review of NRDP is being prepared. Many of the questions raised in this section concerning the conflict between short-run imperatives of policy reform and long-run requirements of agricultural intensification should be clarified in the review.

primarily through a reduction in public sector expenditure. While the adjustment program in Malawi places high priority on sustaining adequate recurrent outlays for agricultural services, it has proved difficult to achieve sufficient expenditure switching to compensate for the adverse effects of a budget rationalization program on recurrent expenditure in the short- and medium-term, and on development investments in the longer-term.

The Need for a "Hybrid" Approach to Bank Lending for Agriculture

63. As the above examples illustrate, adjustment lending tends to be marked by economywide measures (eg. elimination of budgetary deficits) that may conflict with the policy and institutional requirements of investment loans (eg. support for small farm development). To some extent this reflects the inevitable conflicts arising from scarcity of resources. However, scarcity of resources is all the more reason to ensure that the policy and institutional underpinnings of different lending instruments are consistent. A related problem stems from the confusion regarding the policy domains covered by each operation. The danger is that with a wide spread of activities and levels of conditionality in adjustment programs, the implementation performance of these loans will suffer from a multiplication of components without adequate regard for their feasibility or appropriateness within particular lending instruments. Thus, in addition to consistency between the policy and institutional basis of investment and adjustment loans, a further issue concerns the appropriate blend of policy and project lending.

64. A review of those countries in SSA that have undertaken Bank-assisted structural adjustment programs suggests that adjustment lending substantially alters the nature of project assistance. During the early stages of adjustment lending, there is a tendency for investment loans to be suspended while support for technical assistance, import credits and institutional development is strengthened. Since Kenya initiated its adjustment program in 1980, for example, the agricultural sector has received no new specific investment loans. Many of its investment loans initiated prior to the adjustment program were subsequently either cancelled, redesigned, or broken into their component parts to serve as

pilot projects. Since then its agriculture lending program has been composed of technical assistance loans, financial intermediary loans, sector investment loans and a sector adjustment loan. All of these loans have been very closely fitted into the macro policy framework established under the Bank-support structural adjustment program. Projects in the pipeline indicate that once these policy reforms have been implemented and institutional capacity has been strengthened, productive investments will be resumed.

65. A loan programming model that starts with structural adjustment loans and works down to sector adjustment loans and then to project-based investment loans would seem prima facie to represent an effective lending strategy for SSA. However, it is a mistake to sequence agricultural lending in this way for African countries. Without the capacity to respond rapidly to policy reform, the result will be short-run economic destabilization. The capacity to respond to enhanced economic incentives requires both institutional strengthening to increase the absorption of production stimuli in the short-run and investment to shift the production possibility frontier outwards in the long-run. The main production shifters are technological change, institutional development, infrastructure and education.

66. Adjustment and investment operations should thus be seen as complementary parts of the same assistance package and not as mutually exclusive alternatives. Greater use should be made of "mixed" or "hybrid" loans combining adjustment (ie. policy-focused), investment (ie. program-focused) and institutional components. Hybrid lending operations should proceed only after agreement has been reached between the Bank and borrowers concerning the resolution of macro-policy issues and the design of a broad sector strategy. The scope of such operations (ie. the policy domain and investment program coverage) should be less comprehensive than current sector adjustment loans with more modest conditionality to improve prospects for implementation and monitoring.

67. Given agreement on the broader macroeconomic and sector strategy issues, specific financing packages should be devised that focus on policy

and institutional reforms and investment programs at the subsectoral level defined on the basis of commodities and/or lead institutions (eg. dairy cooperatives, smallholder tree crops, lakeshore fish supply and marketing). In other words, the Bank should move in smaller steps on both adjustment lending and investment lending simultaneously at the subsectoral level, minimizing the distinction between the two types of operations. Hybrid loans would contain elements of program financing (eg. recurrent inputs and maintenance), specific investment (eg. machinery, minor civil works) and training and technical assistance. Moderate conditionality would be attached in areas in which action can be taken at the subsectoral level (eg. milk price setting mechanism for producers, export taxes and cost recovery for tree crops, participation of private fish traders).[16] While lending commitment will be of a long-term nature, loans would be disbursed over 2-4 year periods in tranches against clearly defined and easily monitored targets. Although hybrid lending will also have an impact on public finance and may conflict with broader economic reforms, its smaller size and subsector focus make it more amenable to modification.

68. One positive result of the Bank's move into adjustment lending is that it has opened up a dialogue with borrowers encompassing all aspects of policy and investment in a way that was difficult to achieve with investment lending. However, in order to secure the basis for developing the complementarities and resolving the conflicting objectives between adjustment and investment operations, the Bank and its borrowers need to move toward agreed sector strategies. Decisions regarding the sequencing

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16/ Recent developments in multilateral lending may force even greater changes in the balance between adjustment and investment lending. The IMF recently received an additional $8.4 billion to augment the existing $3 billion in a special fund for longer-term adjustment lending to IDA-type countries. Since China and India have agreed not to utilize this special fund, it will largely be lent to SSA countries. The terms are over ten-year maturities, five-year grace periods and a 0.5% service charge. This fund, which is to be lent over five years, may require even closer coordination between the Bank and Fund in assembling mutually consistent lending programs to Africa. In addition, since the fund will be exclusively policy based, the balance requirement may push the Bank's lending program to Africa much more heavily toward investment lending.

and content of various lending instruments are likely to be better informed if there is clarity on the medium- to long-term sector strategy. Simple but robust sector models can be of invaluable help in articulating such strategies.[17] This not only has the advantage of providing a rigorous framework and assisting in greater standardization of appraisal and evaluation techniques, but also makes explicit the assumptions concerning linkages between different parts of the sector and about sector response to policy changes. The need to develop sector models that integrate investment-induced supply shifters with policy-induced changes in capacity utilization within a well-defined sector strategy remains pressing. This will also help to a large extent in reducing inconsistencies between the various policy instruments observed earlier.

V. Institutional Development

69. The preceding sections argue that there has been a considerable change of emphasis in the Bank's agricultural lending program in Africa in recent years. Support for commodity-based and area development projects has diminished in favor of increased assistance for programs aimed at inducing policy reforms. With the introduction of adjustment lending has also come a much stronger emphasis on institutional development.

Improving the "Enabling" Capacity of National Institutions

70. Institutional development has three distinct elements. The first -- or "legitimizing" -- function refers to the social norms, contracts, behaviors and values that are acted out through public, private and familial roles. While this aspect is crucial to development, it is one on which aid donors can exert little influence. Bank activities should nonetheless be planned while keeping in mind the nature of the legitimizing

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17/ An important example of the usefulness of simple sector models for Bank lending purposes is the multisector model designed in AGR and applied to various Bank operations.

institutions. The second -- or "enabling" -- activity of institutions refers to the creation of a capacity to plan, organize and implement policies, programs and projects in a sustainable manner. In agriculture, this is manifested mainly through the research, training and extension functions of national private and public sector organizations. The third -- or "delivery" -- aspect of institutional development concerns the organizational and management structure required to deliver goods and services to beneficiaries. Most of the Bank's attention has focused on this latter form of institutional development. Because this study is concerned with the long-term strategic issues in African agricultural development, our discussion concentrates on the enabling aspect of agricultural institutions.

71. Institution-building is critical to the development of African agriculture because of the urgent need to achieve and sustain higher levels of productivity. Until recently, agricultural growth in SSA depended much more on expansions in area under cultivation and rural labor force than on productivity gains. However, in large parts of Africa, increasing land pressure, rapidly expanding populations, and the inability of both the urban and rural sectors to employ labor productively have created a serious problem of labor absorption. The ability of the agricultural sector to generate employment, while at the same time raising productivity and output levels, is the major challenge of Africa's long-term development. This requires a shift towards intensification of agricultural production which, in turn, depends on: (1) strong enabling institutions in research, training, and extension; (2) delivery mechanisms that can deliver modern inputs, including credit effectively and efficiently; and (3) marketing structures that can extend economic incentives to the farm-level.

72. Institutional support for technological change is key to the process of agricultural intensification.[18] However, substantial

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18/ Except in the relatively uncommon instances in SSA where improved field-tested farm technology suitable for small farmers is available and strong institutions exist through which it can be disseminated and supported. See, "Strengthening Agricultural Research in Sub-Saharan Africa: A Proposed Strategy," The World Bank, Technical Department, Africa Region, March 1988.

production build-ups cannot be expected to result from operations in which external resource flows are sustained for only 4-6 years. Technological development that produces results attractive to farmers, particularly those in rainfed areas, and institution-building that creates an indigenous capacity to plan and implement development programs are, in the African context, 15-25 year processes.

73. However, there are certain dangers in a total commitment to the "long haul" approach to African agricultural development. It may lessen the search for types of intervention that can succeed in the short run, despite the disadvantages of input shortages, poor infrastructure, and unreliable public services that will continue to characterize the rural economy for some time to come. It will thus be as important to improve the design of projects with a shorter duration (eg. 4-7 years) so that they offer some positive returns in a suboptimal environment as it will be to implement longer-term programs which seek to strengthen the environment within which investments are made. Integration of relatively short-term projects with a longer-term institutional development strategy is discussed in the next section.

74. In addition to meeting the technological imperative of African agricultural development, institutional strengthening is also necessary to meet the increasingly complex demands of agriculture sector planning. The Bank's focus on adjustment lending, with its advocacy of policy reforms at both the sector and economywide levels, presupposes an internal capacity to formulate, implement, and review policies. Institutional development in this context means creating an indigenous capacity to perform these functions. However, it is not sufficient to build performance capacity for existing functions. Organizations must be made capable of changing and adapting to new challenges and task requirements. Thus institutional development must also involve the internalization of capacities for performance and change within recipient governments.

75. There is no doubt that institutional development is now a major component of the Bank's agricultural sector operations. The failure of earlier attempts to strengthen institutions or parts of institutions

associated with individual investments has been well recognized.[19] However, there remains a general tendency in the Bank to regard successful development assistance as something that ensures a series of pre-determined outputs from projects around which appropriate institutional support needs to be organized. The result of this approach is particularly serious in the case of agriculture. Agricultural assistance programs which are exclusively concerned with achieving the immediate objectives of each discrete loan rather than the creating the overall institutional capacity to design and implement investment programs greatly reduce the prospects for replicating successful interventions. Development assistance should instead help institutions design and implement programs, of which projects would be just one part.

Strategic Implications of Institutional Development

76. Strengthening the enabling functions of institutional development in the African context means that the Bank needs to: (1) strengthen agricultural support services; (2) strengthen institutions in the private sector; and (3) provide technical assistance for institutional development. Some of the strategic implications of each of these issues are briefly discussed below.

77. Strengthening agricultural support services. The Bank's experience with area development lending has shown that line agencies need to be provided with strong technical and financial support from the center.[20]

19/ See, "Institutional Development in Africa: A Review of World Bank Project Experience," The World Bank, OED, Report No. 5085, May 1984.

20/ Bypassing central administrative structures has been a major issue in the Nigerian agricultural programs. Initially, enclave efforts were necessary because of the intensive needs of agricultural development and the weak national structures. Over time, as statewide operations became more the norm, bypassing led to duplication in staffing; confusion of roles; and, on occasion, hostility and undermining by central structures. A recent review of institutional arrangements in Nigerian agriculture established a set of guidelines to be used when setting up agricultural service programs. The guidelines include avoiding duplication in roles and staffing; transferring commercial activities to the private sector and cooperatives; maintaining a strong

Continued on next page

Where central support is weak, attempts to strengthen the peripheral operations of line agencies will invariably be thwarted by shortages of budgetary resources and skilled staff.[21] Enhancing the capacity of public sector support systems, therefore, must move progressively from the center outwards. This requires strategic decisions on: (1) assigning priorities among line agencies or among the services or facilities they provide; and (2) assigning priorities among the regional areas in which line agencies operate. Some form of rolling "master plan" approach to programming assistance for public sector involvement in the agricultural support systems of SSA countries is essential.

78. Given the need for adjustment in the relevant macroeconomic policies and procedures, the Bank should support successive "time slices" of line agency programs where these are appropriately part of the public domain (eg. much of agricultural research and extension, major irrigation and drainage structures, main roads, and technical support for self-help civil works projects). Loan disbursement periods would be fairly short (eg. three to four years); easily monitorable work targets would be set; and task-oriented conditionality would be attached (eg. relating to staffing, budgeting and work planning methods). Further loans would depend on satisfactory progress reviews -- in effect tranching what is essentially a long-term line of credit.

79. Since each agency program time-slice would constitute only a segment of the overall public sector investment program, loan justification based primarily on macroeconomic analysis at the agricultural sector level would be sufficient. It is unlikely that this type of loan programming can be done efficiently, however, without the use of quantitative agricultural

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link between implementing units and parent ministries; and respecting the roles assigned to statutory bodies such as local governments and to the national research and credit systems.

21/ However, where center-state relations are weak, efforts will have to be taken to ensure that national policies and programs are appropriately carried out at the state level.

sector models with strong spatial content. This will generally be an expensive exercise in terms of staff time because of the high costs of data acquisition. Improving the data base should therefore be considered a part of strengthening agricultural support service institutions. Equally necessary will be close monitoring of government budgetary positions to ensure that the recurrent expenditure demands of expanding and/or upgrading agricultural support systems are adequately provided for.

80. As stated earlier, the Bank has already begun to give greater attention to strengthening agricultural support services. One example of the Bank's increased commitment is the recently adopted agricultural services initiative for SSA.[22] The initiative was created to expand the adoption of improved production technology through strengthening the delivery of services to farmers. It is designed to: (1) develop essential agricultural services on a national basis; (2) improve local capacity to manage services; (3) strengthen contact with farmers and design services based on farmers' needs for technology, demonstration, inputs, etc.; (4) reflect a long-term perspective; and (5) take into account the national policy environment. While the initiative contains many of the elements outlined in this study, its success will depend to a large extent on the joint formation by the Bank and borrower of a sector strategy that assigns priorities among line agencies and the functions they perform, as well as the geographic areas in which they operate.

81. **Private sector development**. The Bank and many of its African borrowers have become conscious of the drag on efficiency and growth levied by the near-monopoly/monopsony structure of public sector institutions. This is particularly evident in agricultural marketing where private traders operating with low margins have been pushed into illegal trading at higher costs, and in agricultural production dominated by state farms. The

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22/ This initiative has been given much impetus from the recent work of the Bank's Food Security Task Force, as well as various policy statements within the Africa region. See, for example, "Food Security for Africa," The Food Security Task Force Report, 1988 (draft); and "An Approach to Agricultural Development in SSA," prepared by Kevin Cleaver for the Bank's Long-Term Prospects of SSA study.

dilemma of many countries in SSA, however, is that the size, competence, and institutional capacities of their private sectors are not capable of meeting the demands of this task. Moreover, governments' capacity to plan and manage policies that affect the private sector is limited. The Bank's response so far has been to focus on loosening the constraints imposed by the macro-policy environment on private sector development. A more comprehensive set of actions on several fronts is now needed to promote broad-based private sector development.[23]

82. But there is considerable evidence to show that even when policies are well conceived, the faulty design of regulations and procedures and their poor enforcement by public agencies have had an adverse impact on private sector development. Regulations and the procedures for their implementation may be so cumbersome and time-consuming from the standpoint of the entrepreneurs that they are frustrated and operate instead in the informal sector. Moreover, the information and advice required by private entrepreneurs to respond to enhanced economic opportunities may not be available to all, especially when the capacity of the public and private sector institutions is limited. For these reasons, attention should be given not only to the adequacy of the policy and regulatory framework but also to the capacity and incentives of public institutions relevant to private sector development. In some cases, public institutions will be required to maintain a direct, although reduced, role in marketing activities.

83. The requirements for private sector development in SSA will vary according to the relative importance and severity of problems facing the private sector. In many SSA countries, overregulation of agricultural marketing has been recognized as a major constraint on private trading.

23/ A large part of this discussion is taken from a recent Bank study of private sector development by Samuel Paul, Country Economics Department, entitled: "Private Sector Assessment: Initiating Brief." In this paper, the author offers a framework for assessing the constraints to private sector development. The purpose of the report is to contribute to the process of country strategy formulation and to help identify Bank activities for private sector development.

While deregulation may be an appropriate response under these circumstances, it is an oversimplification to assume that this approach alone will promote the adoption of private trading activities in all cases. In some countries, the private sector is so undeveloped that information and advice on market opportunities and assistance in terms of capital and infrastructure will have to be provided to encourage entrepreneurship and new investment. This is particularly true given the technological and institutional requirements of agricultural intensification in SSA discussed earlier. In countries with a more highly developed private sector, the need will be for closer government collaboration with the private sector.

84. Despite the fact that the Bank's adjustment lending strongly advocates market liberalization and the privatization of publicly-owned commercial enterprises, a review of the sector portfolio suggests that investment operations often ignore feasible alternatives to public sector organizations. There still exists a tendency in many Bank agricultural operations to work through public institutions already performing key functions. This is particularly true with input supply and some veterinary services that could be handled by individuals, cooperatives, or companies in the private sector, and minor civil works that could be handled by local communities.

85. In countries in which agricultural marketing is dominated by government parastatals, private markets are weak, and market power is a problem, the Bank will need to give greater attention to intermediate arrangements for agricultural marketing, services and input supply. Two alternatives to private sector dependence without the full trappings of a parastatal are farmer-controlled input delivery organizations and apex cooperative marketing bodies. Given adequate assistance in their initial phases, these have been demonstrated to provide alternate competitive institutional structures to private enterprise while allowing governments limited intervention either in the development period until the private

sector comes forward or as a cushion against excessive private monopoly or cartels that governments fear.[24]

86. As the private sector is strengthened to assume more marketing responsibilities, some support of public sector institutions will have to be continued. The challenge facing the Bank is to work closely with borrower governments to: (1) define the regulatory functions of their public sector institutions and strengthen the means for their enforcement; (2) assess which activities are best left in the hands of the public sector and which should be transferred to the private market; (3) identify the constraints to private sector development and determine what steps, policy reforms and institutional changes should be undertaken to create improved market conditions; and (4) ensure the lending program reflects a consistent and mutually supportive division of responsibility between private and public sectors.

87. Technical assistance and local skills formation. A recent Bank Task Force on Technical Assistance (TA) identified several issues that hamper the use, absorption, and sustainability of TA. These are: (i) TA is driven more by donor supply than by borrower demand; (ii) project designs often reflect unrealistic assessments of borrowers' needs; (iii) poor coordination of TA by donors; (iv) the cost of TA is very high compared to local salaries; and (v) the shift from "hard" (eg. construction and engineering) to "soft" (eg. training and institution-building) TA creates problems in implementation and monitoring.[25]

88. The main contribution of Bank-provided TA has been to finance the services of foreign advisers and consultants. What has changed in recent years is the more explicit emphasis on the training or advisory function

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24/ The parastatal input supply companies in Nigeria, for example, have been set up so that they can be transferred over time by the purchase of shares by farmers cooperatives into farmer-owned, and thus private, organizations.

25/ See, "World Bank Technical Assistance Activities and Issues: FY82-86," The World Bank, Report No. R87-209, September 14, 1987.

rather than the operational function of TA, and the recognition that institution-building objectives and not output objectives are paramount. This shift in role of external advisors and consultants is reflected in the definition of TA in the Task Force's report as activities that "enhance human and institutional capabilities through transfer, adaptation and utilization of skills and technology." This change in the role of TA is evident in several recently approved operations in SSA. (See Box 5.)

Box 5

The Experience of Technical Assistance in The Industrial Forestry Project in Zambia

In 1982, Zambia asked the Bank to finance Phase III of its afforestation program. The division of the Forestry Department that implemented the earlier phases had been incorporated into a state-run company known as the Zambia Forestry and Forest Industries Corporation (ZAFFICO). In response to management problems during the initial phases, an external team has hired to improve ZAFFICO management before initiating Phase III. Several months before implementation, however, concern over persistent management weaknesses led the Bank to employ a consultant to look at management practices and to recommend ways to improvement its performance.

A number of problems were identified. First, the transformation of ZAFFICO from a public body to a commercial enterprise caused confusion among staff over their roles under the new organizational structure. Second, the relationship between external and local managers was characterized by distrust. Foreign managers were hired at the Bank's behest over the objections of ZAFFICO and local managers were demoted to counterpart status. Third, the external external managers assumed control over many basic tasks rather than train local staff. Fourth, weak management was aggravated by slow implementaion of the project's training component.

In response to these findings two workshops on management leadership and staff relations were held. The workshops were designed to initiate a management team-building process and represented the first step in defining a strategy to examine the role of exteral assistance and to address staff relations with with management. Since the workshops were held, ZAFFICO has begun to develop as an institution and to experience a higher degree of staff motivation.

89. The Bank has also introduced several new lending facilities to improve the flow and impact of technical assistance. New instruments such as the Project Preparation Facility (PPF), the Special Project Preparation Facility (SPPF), and the TA Program for IDA Countries have been introduced to strengthen the advisory, training and institution-building activities of TA. Renewed efforts have also been made to enhance TA-financing by UNDP and other donors. However, while the role and function of TA have been redefined to reflect both the changing requirements of the Bank's agricultural lending program and the changing needs of its SSA borrowers, the strategic implications of this new role have not yet been fully recognized by the Bank.

90. First, institution-building must be sustainable. TA, rather than substitute for local management, should help to improve it -- and to build up the confidence of local staff in their own abilities. While the project may proceed more slowly and less smoothly if TA is focused on training rather than implementation, the prospects for the project being sustained after TA personnel are withdrawn are considerably greater. Second, training activities should be separated from direct operational support activities. If these two functions are in conflict, TA resources tend to concentrate on the latter because the results of operational support are more visible, and therefore easier to justify, than the results of the former. Third, support for long-term institution-building is best provided by training resources from within the borrowing country. The Bank should encourage the development of local capacities to broaden borrower experience and reduce the cost of TA. Wherever possible, Bank operations should enlist the assistance of local universities, institutes, or private sector organizations in the provision of technical and management support.

91. Along these lines, the Bank should take an active role in helping governments to strengthen their own planning and management of TA by improving the use of market mechanisms to search for local talent, establishing an inventory of sources of TA with a view to utilizing the most cost-effective sources, and making a special effort to repatriate nationals who have left the country. One approach to institution-building which has proved effective in a number of cases is 'twinning' arrangements:

the linking of local institutions with better-established institutions, preferably from other parts of Africa or other developing regions.

92. Three obstacles to the use of indigenous technical expertise -- even where such expertise is available -- should be noted. First, these resources are not always available locally. Second, borrowers are sometimes reluctant to hire local specialists either because they do not want to employ consultants from other African countries or because they do not want to employ their own consultants at international prices. Third, training of local staff must be supported by an adequate incentive structure and good working conditions. No amount of training will build an institution if local staff are unwilling to build their careers in the institution. Implicit in overcoming these obstacles is the need to work closely with borrowers on all aspects of technical assistance. Only by doing so can the Bank help identify the reasons for the poor results of technical assistance and convey to its borrowers its eagerness to collaborate with them in improving the effectiveness of TA.

93. In sum, recent Bank activities reflect a growing awareness of the need to strengthen the institution-building objectives of its agricultural lending program in SSA and to perceive those objectives within the broader policy environment. This view is evident in the work of Bank task forces on such issues as private sector development and technical assistance, in the innovative approach to institution-building in some lending operations, and in some of the internal structural and operational changes instituted during the reorganization. But, if the Bank is to achieve the dual objectives of improving agricultural incentives in the short run and removing the technological and institutional constraints to production in the long run, it will have to change the way it carries out program planning and implementation.

VI. Borrower Commitment

94. For many years the Bank assumed that good projects generated commitment on the part of the recipient government. Staff energies were concentrated on the physical "output" of the project; the process through which the loan agreement between the Bank and the recipient government was reached was incidental. Evaluations of operations have shown, however, that insufficient borrower commitment to project investments -- resulting in part from the lack of attention given to their involvement in the project design, preparation and implementation process -- has been an important factor in explaining widespread project failure.

Internalizing the Project Cycle

95. In all cases in which reforms are involved, borrower commitment requires that governments regard the reforms as their own and not the Bank's. This in turn requires that the agencies and individuals that will implement the programs and projects be involved at all stages of program development. However, for a number of reasons (eg. lack of qualified planning personnel, borrower unfamiliarity with the Bank's procedures, technically complex design criteria, etc.), this principle is often overlooked in transactions between the Bank and its clients. Program identification and preparation have been viewed as something done by, or on behalf of, the Bank in order to meet its own requirements for loan approval. Externalizing loan preparation is especially serious in the case of agricultural lending operations, which need to be closely fitted to physical and social environments and involve the cooperation of numerous groups.

96. Internalizing the project cycle within recipient governments requires an acceleration of an already perceptible change in attitude on the part of Bank staff: to realize that the preparational process is as important as the operational product. At present, the major share of the Bank's technical resources is devoted to analysis and problem-solving on behalf of its borrowers and, subsequently, to convincing borrowers of the validity of the Bank's prescriptions. More attention should be given to developing collaborative working environments in which the Bank and borrowers develop mutually acceptable designs and implementation programs

for projects and policies rather than maintaining the Bank-to-borrower flow of economic and technical diagnoses and prescriptions. Under such a collaborative approach, the Bank's role would be to provide analytical support and advice utilizing relevant operational experiences from other countries. It is on the basis of this type of collaboration that government decisions about packages of policies, formation of institution-building programs, and design of investment projects can be reached and sustained.

97. The collaborative approach to loan appraisal is mainly concerned with establishing that: (i) satisfactory institutions and operational procedures exist in the borrower agency for developing whatever detailed planning would be needed for the operation; and (ii) the objectives, scope and plan of the operation are consistent with the sector strategy agreed between the Bank and government. While a review of project documents reveals that previous investments tended to concentrate first on expanding output capacity and then on creating an institutional structure to support it, a collaborative approach would focus on developing an institutional structure with its own internal capacity to design, implement and sustain productive investments.

98. To a certain extent, this idea is already reflected in adjustment programs. It is also beginning to be incorporated in investment operations. For example, the latest state-wide ADPs being prepared with the Nigerians support the state's agricultural sector development plan and contain elements of the flexible, collaborative approach. Collaboration has also been encouraged through action planning and project launch and implementation workshops. The basic idea of the workshop is to assemble local project teams to undertake the work of project design, assisted by Bank staff and consultants. A series of workshops is convened at the beginning and at strategic stages along the way as the design takes shape. The purpose of the workshops is to provide a forum for consultation on key policy issues with those agencies and individuals likely to have a stake in the operation. (Box 6 below illustrates how collaborative planning techniques applied during implementation have succeeded in improving project performance.)

Box 6

Collaborative Approach to Project Preparation and Design: The Wood Energy II Project in Malawi, 1986

In 1986 the Bank agreed to finance the second phase of a wood energy program. While Phase I largely met its physical targets, the project faced two major problems: weak management of plantations resulting in high costs and low yields; and poor wood conservation and adoption rates by private farmers due to low and poorly enforced stumpage rates and easy access to free wood in unprotected forests. On the basis of a sector study and discussions with Government, loan agreement was made conditional on changes in institutional structure, management and incentives policy. To make these changes effective, the Bank proposed holding two Project Implementation Workshops: one for senior staff and one for field staff.

The concept behind the workshops was to familiarize those involved in the project with its aims and to encourage participation and dialogue between implementing groups. The workshops were designed to build commitment and achieve consensus concerning key decisions and future plans. As part of this collaborative process, the Bank has also tried to build increased flexibility into the project. The project M&E Unit is to submit semi-annual reports focusing on the innovative elements of the project. The Management Planning Unit is to set targets and cost estimates before the start of each fiscal year. The Energy Unit is to carry out an annual survey of wood market prices and production costs to determine stumpage rate changes. Finally, a joint midterm review is to be carried out to modify project design if necessary. A second set of workshops is scheduled to be held with project staff in 1988 to evaluate jointly the performance of the project and discuss any changes in its design that need to be made.

99. Apart from being more responsive to locally-perceived development needs and reflective of indigenous solutions to meeting these needs, the collaborative approach has two advantages over conventional practice (which is to hire consultants to design operations for, rather than with, governments). First, collaboration mobilizes support for the program concept and secures commitment from the agencies involved to put the plan into effect. The second advantage of collaborative design is that it minimizes the likelihood of inter-agency conflict arising during implementation. Problems are avoided because lines of communication and an

agreed implementation plan are established during the design process. It was revealed during interviews with Bank project staff that with standard project preparation, the implementing agencies are sometimes informed only after loan appraisal that they will be participating in a project and that a committee will be set up to coordinate their work. (Box 7 provides a case study in which the implementing agency was made an integral part of the project planning and design process.)

Box 7

Collaborative Exercises for Project Preparation: The Forestry II Project in Zimbabwe

The success of a project requires a close identification and commitment by the borrower to the project. This is fostered by early collaborative actions by the borrower and the donors in all aspects of the project. The collaborative planning process was successfully employed during the preparation phase of the Second Forestry Project in Zimbabwe.

First, under Bank leadership, the borrower, co-financiers, and the Bank discussed the concept of the project. The Forestry Commission -- the implementing body -- was asked to prepare an outline for the project, which was latter discussed, modified, and agreed to by all parties. Second, the Forestry Commission, with Bank assistance, prepared a concept paper based on the outline in which the objectives, description, benefits, and risks of the project were presented. The paper was then discussed in a workshop attended by the relevant ministries. The purpose of the workshop was to inform and solicit consensus and commitment from the ministries engaged in the project. Third, the borrower was asked to draft, under Bank guidance, a pre-appraisal report along the lines of the concept paper. When the report was complete, a preparation mission consisting of the Bank and co-financiers visited Zimbabwe to finalize project preparation.

Throughout the process, the Bank remained in the background, giving principle responsibility for project planning to the borrower while, at the same time, ensuring the final product was consistent with Bank standards. The result is that the borrower identifies closely with the project, and that the co-financier is knowledgeable about the project and its related issues. The collaborative planning process is also expected to facilitate project processing and improve the chances for successful implementation. Collaborative planning techniques are also being used in the Agricultural Sector Adjustment loan in Mali and the Agricultural Support Services project in Niger in which local working groups have been formed to prepare papers on various aspects of the projects. These papers will provide the basis for discussions between the Bank and the borrower and ultimately lead to project design.

100. While supported by some Bank staff, the use of collaborative design techniques such as action planning workshops has not yet become standard procedure in the Bank. At present they are applied in only a

small number of operations. The reason for their infrequent use is mainly the lack of staff familiarity with the techniques and a scarcity of experts who can apply them in the field. Collaboration involves much more than assembling representatives of the borrower agencies and soliciting their views on operational design. The process must be analytically sound, culturally acceptable, carefully structured and expertly managed if those involved are to be motivated to identify problems and seek solutions. Without such analysis, structure and management, workshops often deteriorate either into dictation exercises or complaint sessions. Yet, there is little evidence of consulting firms hired to assist with program preparation being instructed in the use of collaborative planning techniques or being selected for assignment based on demonstrable skills in this area.

Strategic Implications of Collaborative Planning

101. Collaborative planning for agricultural operations should be taken more seriously by the Bank and more effort put into finding ways to incorporate successful techniques into Bank procedures. The wider adoption of collaborative planning techniques carries important implications for Bank staffing and operations. First, decentralization of the Bank's decision-making structure and lending procedures is necessary to make the link between joint planning and funding more direct. To some extent, this link has been established under the reorganized Bank. Under the new structure, country department directors have authority to make decisions regarding the design of country and sector strategies. Moreover, the Bank is not used to dealing with the output of collaborative efforts. Bank management may worry that if greater authority to design programs lies with project-level operations staff and government officials, Bank positions on sensitive issues may be compromised in an effort to reach agreements. There are legitimate concerns here about loss of quality control -- they should be addressed and a case made that the risks are worth it.

102. Second, greater rewards should go to staff who demonstrate an ability to build consensuses with borrowers on priorities for action and to maintain commitment to ensuring action is taken. Project staff often

complain that the Bank's incentive system is biased in favor of those who maintain the timely flow of well-written reports. This works against collaborative planning, which can be a time-consuming process and does not necessarily result in operations design entirely in accord with the Bank's normal guidelines.

103. Third, collaborative planning requires a greater share of staff time in the field. There are indications that the Bank is already moving in this direction through such measures as increased numbers of resident representatives and the creation of larger numbers of agricultural staff positions in the field. Collaborative planning also increases the Bank's need for more frequent and intensive supervision. Despite this growing need, the share of Bank resources for project supervision have been reduced. Clearly, the greater budgetary demands of increased staff intensity in field operations will have to be considered. Fourth, collaborative planning requires greater continuity in staff assignment to operations so that staff can establish closer working relations and familiarity with government officials. The new structure of the Bank with its strong country-focus should help establish better country continuity of Bank staff. Not least of all, Bank staff will need to be trained in collaborative action techniques.

104. It needs to be pointed out, however, that collaborative planning faces a number of risks from the point of view of the borrower. There is the problem of whom to involve in the collaborative planning exercise. Some governments are extremely suspicious of efforts to include private companies, universities, voluntary organizations and other bodies outside the public sector regardless of their relevance to the operation under discussion. Governments may view this approach as an attempt by the Bank to mobilize a lobby in favor of the Bank's preferred solutions.[26]

26/ For example, an attempt to sponsor a workshop involving government officials and academics in Nigeria on organizational options for agricultural services encountered resistance from the government apparently because it believed the Bank had already selected its option.

105. There is also the difficulty of ensuring that beneficiary interests are represented in the collaborative planning process. Even when the Bank designs operations with rather than for governments, the danger that both Bank and government are designing operations for rather than with beneficiaries remains. In fact, the reflection of beneficiary concerns in planning may be less likely with the collaborative model than the traditional model in which the Bank can require consultants to include anthropologists and sociologists in project teams. Many African governments resist the use of these consultants in the belief that nationals understand the socio-cultural factors behind development constraints and opportunities better than outside experts.

106. One way to increase the likelihood that investments will benefit target groups is to initiate pre-preparation field studies before launching action planning workshops. During this period, governments would be encouraged to hire professional staff with broad experience relevant to projects (eg. agricultural economists, livestock specialists, sociologists, anthropologists) to work closely with the line agency concerned (or the area development agency in a decentralized administrative system) at the field level. The objective of a pre-preparation field study is to identify technological resource developments that appear promising, locate beneficiary groups, and explore organizational options with locally represented organizations. The data would be used to outline alternative project designs that would act as a starting point for the action planning workshop and main project preparation.

VII. Summary and Conclusion

107. The preceding discussion points to the need for strategic changes in the Bank's agricultural lending program. Because lending problems in SSA are associated with both policy deficiencies and a lack of productive capacity and technological advances in agriculture, the emphasis has been is placed on a careful combination of policy change <u>and</u> investment. The

study finds that policy changes currently pursued through adjustment lending are necessary, but must be complemented by and consistent with investment lending to obtain a sustained supply response from agriculture. In addition, sustained agricultural output requires stronger supportive rural institutions and the development of human resources. This, in turn, requires borrower and beneficiary commitment to Bank-financed initiatives.

108. The paper argues that the Bank should favor hybrid policy-based/investment operations that are most likely to assure the vital link between policy reform and productive investment. While structural adjustment loans should focus on the macroeconomic and monetary policy framework (as well as incorporate resource transfer objectives), smaller hybrid policy-based/investment operations should focus on sector policies and priorities. Hybrid lending operations should contain elements of program financing, specific investment, and technical assistance. However, hybrid loans should be less comprehensive than current sector adjustment loans. They should focus on policy and institutional reforms and investment programs at the subsectoral level defined on the basis of commodities or lead institutions.

109. The first priority for achieving a shift in agricultural lending is institution-building. The paper underlines the importance of agricultural intensification for SSA as its population continues to grow. Population growth will increase the demand for farm products. Constraints on area expansion as well as other physical limitations will restrict this source of satisfying increasing demand for agricultural produce. Hence the need for intensification. The study concludes that agricultural intensification will only occur if those institutions that provide farm services function effectively. Such services include research, extension, input supply, marketing and credit. They may be provided by either private or public sector organizations depending on the nature of the service and the efficiency of the private sector. However, to get either institutional system to function effectively requires institution-building and human resource development.

110. The second priority for achieving such a shift is to generate greater borrower commitment to Bank-financed policy and investment programs. To do this requires that governments and beneficiaries regard such programs as their own. The process of preparing projects and programs should be regarded as important as the product of the loan since the former will often determine the degree of commitment of the borrower. Generating commitment requires specific effort by the Bank such as the use of workshops in project preparation, posting more staff in the field, ensuring greater continuity of staff with the same borrower, providing training to staff in collaborative project planning techniques, and making sure staff incentives reflect the importance of commitment building.

111. While many of the policy conclusions offered in the paper appear to be common sense and already incorporated in the new structure of the Bank, the study finds that much of what is being done in Sub-Saharan Africa is inconsistent with the above prescriptions. The paper finds that instead of greater emphasis on agriculture, Bank lending to agriculture is declining, policy-based operations often are not adequately supported by investment operations, hybrid policy-based operations are still unusual in agriculture, little is done to generate borrower commitment, and institution-building is often secondary to "getting the project done." Many of these changes are reflected in the new organization of the Bank but they still need encouragement.

Appendix B

World Bank Lending for Area Development, 1974-87
(US$ million and as % share of ARD lending)

Year	World ARD Lending (US$M)	World AD Lending (US$M)	World AD as % World ARD (%)	SSA ARD Lending (US$M)	SSA AD Lending (US$M)	SSA AD as % SSA ARD (%)
1974	955.9	203.8	21.3	201.9	60.8	30.1
1975	1857.6	630.5	33.9	447.2	143.0	32.0
1976	1627.6	407.3	25.0	185.6	61.8	33.3
1977	2307.9	567.1	24.6	397.9	206.1	51.8
1978	3269.7	560.9	17.2	361.1	104.2	28.9
1979	2521.8	761.2	30.2	372.7	131.3	35.2
1980	3458.4	451.0	13.0	480.5	241.6	50.3
SUBTOT	15998.9	3581.8	22.4	2446.9	948.8	38.8
1981	3763.0	755.5	20.1	664.1	419.0	63.1
1982	3078.4	902.4	29.3	466.5	241.1	51.7
1983	3698.3	980.4	26.5	420.2	112.3	26.7
1984	3472.9	507.0	14.6	670.3	228.1	34.0
1985	3749.3	701.1	18.7	350.0	89.4	25.5
1986	4778.5	458.3	9.6	434.7	257.3	59.2
1987	2930.3	937.0	32.0	519.2	57.1	11.0
SUBTOT	25470.7	5241.7	20.6	3525.0	1404.3	39.8
TOTAL	**41469.6**	**8823.5**	**21.3**	**5971.9**	**2353.1**	**39.4**

Source: World Bank data files

August 30, 1988

880909003

The World Bank

Operations Committee

CONFIDENTIAL

Minutes of the Operations Committee to Consider
THE GAMBIA: Second Structural Adjustment Credit (SAL II)
Initiating Memorandum

Held on August 30, 1988 in Conference Room E-1243

A. Present

Messrs. A. Karaosmanoglu (Chairman)
J. Holsen (VPDEC)
P. Isenman (AFRVP)
H. Scott (VPLEG)
W. Thalwitz (EMNVP)
H. Vergin (SVPOP)
J. Wood (VPFPR)

Others

Messrs. R. Armstrong (AFRCE)
K. Awunyo (LEGAF)
V. Dubey (EAS)
L. Hinkle (AF5CO)
R. Knapp (AFTPS)
D. Mahar (EAS)
W. Schwermer (CODOP)
Ms. E. Makonnen (SPRPA)
Ms. D. Williamson (AF5CO)
Mr. Rothman (IMF)

B. Issues

1. The meeting was called to consider the Initiating Memorandum for the Second Structural Adjustment Credit (SAL II). The IDA amount proposed in support of SAL II is US$ 18 million. The discussion generally followed the agenda prepared by EAS dated August 25, 1988, although other issues were also raised. The topics discussed may be broadly grouped in the following categories: (i) longer-term development prospects; (ii) policy content of proposed operation; (iii) government expenditures; (iv) public enterprise reform; (v) civil service reform; and (vi) retroactive financing.

C. Discussion

2. Longer-term prospects. Several members of the Committee inquired whether The Gambia, given its small size and limited natural resource base, possessed the necessary ingredients to develop a viable national economy. The Region responded that, while the country is unlikely to achieve a high degree of economic diversification, it should be able to sustain modest positive per capita growth over the longer term. Indeed, it was felt that The Gambia had fairly good prospects compared to other Sahelian countries. In addition to tourism and fishing, the Region believed that the country had some potential to

diversify away from groundnuts and into subsistence cereal crops and horticulture. It was further pointed out that external imbalances are presently high as a proportion of GDP but that they are actually quite small in absolute terms. In this regard, the Region felt that the current account deficit would only need to decline by a few percentage points of GDP in order to reach a sustainable level.

3. The Chairman thought it would be useful to explain in more detail in subsequent drafts of the project documents how national economic viability would be attained, and to deal more explicitly with the diversification issue, especially in regard to the rural population.

4. Policy content. In response to questions from the Committee concerning the policy content of the proposed operation, the Region stressed that SAL I was implemented well. But since the reform program supported by this first adjustment operation was very comprehensive, there was a need to follow-up, especially in the areas of banking, groundnuts policy, and diversification into fishing and tourism. The Chairman asked whether the policies in the groundnuts subsector being supported under the proposed operation were consistent with those being supported under Bank-supported adjustment operations in neighboring Senegal. The Region replied in the affirmative, but said that progress on policy reform in Senegal has been slower than in The Gambia owing mainly to the former's status as a CFA country.

5. The Chairman suggested that the Region might clarify the meaning of the term "deepening the adjustment process" in subsequent drafts of the project documents.

6. Government expenditures. One member of the Committee asked whether the Region was satisfied with the quality of The Gambia's public investment program. The Region said it was, citing the PIP's emphasis on human resource development, agriculture and maintenance of infrastructure. It was further pointed out that the Bank's insistence on annual reviews of the PIP did not signify a lack a commitment on the part of Government, but rather an attempt to support Government's efforts to resist pressures to alter the program in inappropriate ways. Another Committee member inquired about the source of public expenditure cuts and in particular about the role parastatal deficits in this regard. The Region acknowledged that the deficits of the Gambian Produce Marketing Board (GMPB) and the Gambia Utilities Corporation (GUC) had necessitated large budgetary transfers in the past but informed the Committee that these transfers had since been substantially reduced as part of the country's adjustment program.

7. Public enterprise reform. The Committee asked several questions on this topic. One question referred to the degree of interest on the part of the private sector to purchase public enterprises. The Region reported that interest was high and that two commercial ventures had already been divested and that three others were expected to be sold by the end of this year. Another question concerned the possibility that government monopolies would be transformed into private monopolies through the divestiture process. The Region felt

that the risk of this happening was low since the public enterprises due to be sold were small and competing private firms in the same lines of business already existed. With respect to firms that were to be kept in the public sector, the Region felt that performance contracts were probably a useful means of defining better the respective roles and responsibilities of the Government and the parastatals, but that the practical experience with this instrument has so far been limited. Finally, the Region explained that the proposed Enterprise Development Project would complement SAL II by, inter alia, strengthening the capacity of the National Investment Board to improve the efficiency of the remaining parastatals.

8. Civil service reform. The Chairman requested that the Region provide a brief overview of the proposed grading and pay reform and its budgetary implications. The Region stated that, at present, grades are poorly defined in the Gambian civil service and that pay scales often bear little relationship to the nature of the job. The grading and pay reform would be expected to remedy these problems by reducing the number of grades, by grading given jobs appropriately in relation to others, and by adjusting pay scales accordingly. The Region said that the budgetary implications of this reform will not be entirely clear until appraisal, but that it was felt that the total public sector wage bill could be kept within acceptable limits. The IMF representative agreed with this assessment.

9. Retroactive financing. The Committee asked the Region to provide a fuller explanation of why the maximum amount of retroactive financing (20 percent of credit) was needed for the proposed project, particularly taking into account the intent of the Dutch Government to disburse its contribution as soon as possible after loan signing. The Region noted that the last disbursement from SAL I was made in November 1987. As a consequence of this, staff felt that a failure of the Bank to agree to retroactive financing could interrupt the flow of imports into The Gambia and thus disrupt the implementation of the adjustment program. The Chairman felt that the case for retroactive financing would need to be strengthened in subsequent drafts of project documents.

10. Other. One member of the Committee asked whether The Gambia had been complying with restrictions on the contracting of additional external debt. The IMF representative said that compliance has been very good. He also noted that the country's arrears have been reduced substantially and that foreign exchange reserves have been increased.

September 6, 1988

DMahar:pl

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

1.

DATE : August 25, 1988

TO : Operations Committee

FROM : Vinod Dubey, Director, EAS

V Dubey

SUBJECT: THE GAMBIA: Second Structural Adjustment Credit (SAL II) Initiating Memorandum - OC Meeting Agenda.

1. The Operations Committee will meet on **Tuesday, August 30, at 4 p.m. in Room E-1243** in order to discuss the above-referenced document which was circulated on August 18, 1988 under separate cover. The IDA amount proposed in support of the SAL II is US$ 18 million. With expected co-financing from the African Development Bank (UA 10 million) and the Government of the Netherlands (Guilders 5 million), the total financing package would amount to about US$ 33 million.

Background

2. The Gambia is a small (population 775,000), poor country (US$ 230 per capita income) with an undiversified economy. The vast majority of the population is engaged in small-scale agriculture; groundnuts account for about 75-90 percent of the country's domestically-produced exports. From the mid-1970's to mid-1980's, The Gambia's main economic indicators deteriorated substantially. Large internal and external imbalances emerged during this period, leading to a near-exhaustion of the country's foreign exchange reserves, shortages of basic imports, and negative economic growth. Although adverse external factors and climatic conditions explain part of this deterioration, the main causes were inappropriate macroeconomic and sectoral policies.

3. Starting in 1985, the Government has sought to turn around the country's economic situation through an Economic Recovery Program (ERP) aimed at improving monetary and fiscal discipline, and at increasing the role of market forces in economic decision making. The ERP, supported by both the Bank (through SAL I) and the IMF (through a SAF), has already achieved impressive results: economic growth rebounded to 5 percent in both 1986/87 and 1987/88, the inflation rate has fallen, and foreign exchange reserves have increased. However, severe problems still persist in the form of a large fiscal deficit (20 per cent of GDP), a debt service ratio approaching 50 percent, and widespread poverty. The proposed SAL II would support the Government's efforts to broaden and deepen the structural adjustment program in the 1988/89-1990/91 period. Additional support for the Program is expected from the IMF through an Extended Structural Adjustment Facility (ESAF).

Issues

4. The Region reports that The Gambia's ERP is essentially on track and that there are no outstanding issues with the IMF. However, the Committee may wish to discuss the following issues:

5. Policy content. The proposed operation bears a number of similarities to SAL I. The Region may therefore wish to provide the Committee with a brief overview of the policy content of the proposed SAL II, differentiating between new policy reforms, reforms expected under SAL I but not fully implemented, and the maintenance of reforms initiated under SAL I.

6. Public investment program. The IM (para. 30) states that The Gambia's PIP adequately reflects current development priorities, i.e., emphasis on rehabilitation and maintenance, development of support services for private sector in agriculture, projects with positive foreign exchange impact, and human resources. The Region proposes to review the budget annually (both development and recurrent) in order "to ensure that Government's commitment to the [agreed] priorities are maintained."

> Does the Region's insistence on reviewing budgets annually imply that there is a lack of commitment to proper planning and budgeting on the part of Government? Does the Government have the technical capacity to analyze and prioritize investment projects and to evaluate the recurrent cost implications of these projects? If not, what is the Bank doing to enhance this capacity?

7. Agricultural policies. Given the importance of groundnuts in the Gambian economy, a key element of the proposed operation (as it was under SAL I) is to bring domestic producer prices more in line with world prices in order to eliminate subsidies and to encourage crop diversification (para. 31). Since 1986, falling world prices have necessitated a cut in the producer price of 39 percent.

> The Region may wish to brief the Committee on the interim results of the Government's groundnuts pricing policy. What has been its impact on farmers'incomes? To what extent have subsidies to the Gambia Produce Marketing Board been reduced? What is the timeframe envisaged for eliminating these subsidies entirely? What concrete plans does the Government have to open up groundnut processing and marketing to the private sector? How serious is the risk (given the ease of cross-border trade) that The Gambia's groundnut pricing policies will be frustrated by the existence of higher producer prices in neighboring Senegal?

8. Civil service reform. Since the mid-1980's, the Government has retrenched thousands of public servants as part of the ERP. However, a grading and pay reform, which was expected to be carried out by the end of 1987, has not materialized because of problems with a consultants' study (para. 40). The Government is currently preparing a list of steps to be undertaken so that the reform might be completed by Board presentation.

> The Region may wish to provide the Committee with further details on the expected grading and pay reform, including its scope, content, and budgetary implications.

9. <u>Public enterprise reform</u>. The objectives under the proposed SAL II would be to support the Government's ongoing efforts to reduce the size of the public enterprise sector through divestiture, and to improve the economic and financial performance of those firms expected to remain in the public sector (paras. 42-47). The latter objective is to be implemented through the extended application of performance contracts.

> <u>Although the Government may wish to sell selected public enterprises, have private entrepreneurs manifested an interest in purchasing them? If purchasers are not identified, are the firms in question to be liquidated? What has been the experience so far with performance contracts? Are public enterprises given enough autonomy (e.g., over prices and tariffs and labor force) to enable them to operate without subsidies? What is the relationship between the proposed Enterprise Development Project and SAL II?</u>

10. <u>Retroactive financing</u>. The IM proposes (para. 48) to provide retroactive financing up to 20 percent of the IDA credit amount. However, the rationale ("to facilitate rapid disbursement") is weak and it is not made clear what time period this proposal would cover. The Region may therefore wish to clarify this point to the Committee.

cc: Messrs: D. Lee (COD), A. Shakow (SPR), J. Holsen (CEC), D.C. Rao (FRS), Burmester/Thahane (SEC), R. Liebenthal (SPRPA), A. Steer (FRS), T. Baudon (SVPOP), S. O'Brien (AFRCE), M. Gillette (AF5DR), L. Hinkle (AF5CO), D. Williamson (AF5CO).

<u>For Information Only</u>:

D. Hopper (SVPPR), D. Bock (DFS), D. Golberg (VPLEG), R. Frank (CFP), J. Parmar (CIO), G. Pfefferman (CEI), J. Baneth (IEC), M. Haug (EXC), J. Tanaka (EXC), C. Robless (OPNMS).

DMahar:pl

August 9, 1988

The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

Minutes of the Operations Committee to consider
NIGERIA: OSO Field Development Project
Held on August 9, 1988 in Room E-1243

A. Present

Committee

Messrs. M.A. Qureshi (Chairman)
P. Hasan (EMNVP)
M. Gillette (AF5DR)
R. Steckhan (LA2DR)
O. Yenal (ASIVP)
D. C. Rao (FRS)
H. Vergin (SVPOP)
H. Scott (VPLEG)

Others

Messrs. J. Adams (AF4CO)
S. Aiyer (AF4IE)
A. Alizai (CA2DR)
F. Batzella (ATFIE)
J. Barrientos (AF4DR)
F. Chaudhri (EAS)
G. Dahl (IMF)
Ms. J. Edstrom (AFRVP)
M. Farhandi (AFTIE)
E. Grilli (EAS)
A. Heron (CODOP)
D. Lee (CODOP)
T. Mante (CA2D2)
Ms. B. Santos (LEGAF)
E. Schertz (CODPR)
A. Steer (FRS)
J. Tanaka (EXC)
A. Toft (DFS)
J. Toureille (AF4IE)

B. Issues

The issues discussed by the OC centered on the nature of the Project, the rationale for the Bank involvement and the respective roles of the Bank and IFC in launching the proposed project; the proposed financing plan; implications of the OPEC quota restrictions; the cofinancier's interest in establishing escrow account and obtaining exemptions from debt rescheduling and Central Banks reserve requirements, and the importance of macropolicy adjustment measures in Nigeria.

C. Discussion

Given the nature of the project -- an enclave operation with commercial characteristics and heavy involvement of the private sector -- the first question raised by the Chairman was, "why the Bank is to be involved and why should IFC not handle it all by itself?"

The Region's response was that it was a large project (approximately $900 million) with large financing needs which were to be met by the Nigerian National Petroleum Cooperation (NNPC) and Mobil Producing Nigeria (MPN) in a 60:40 ratio, typical for petroleum sector joint ventures in Nigeria. While there was interest among the financiers in providing loans to MPN, the prospects of mobilizing non-recourse financing for NNPC without the Bank's support and involvement were virtually non-existent. The major reason for the Bank financing the Government's share in NNPC was that not only could the borrowed funds be serviced by the project itself, but the additional revenues generated by the project would have a large positive impact on Nigeria's foreign exchange situation (and thus on debt service capacity) in a relatively short time. The Region also pointed out that the returns of the project to the Government far exceed those of the sponsors. Also IFC could not handle the project alone since it cannot finance NNPC's needs. In addition, IFC would itself need protection against others' claims on Nigeria's assets even for much smaller operations. In the discussion that followed, however, a general consensus emerged on the desirability of a larger IFC role.

On the question why the project depended fully on borrowed funds, the Region pointed out that all the earlier investments in basic exploration were self-financed. When the exploration and development phases of the project are considered together, the resulting balance between equity and loans becomes quite reasonable.

On the question of OPEC stance on condensate production, the Region's judgement was that (i) condensates are not a frequently occurring deposit and exclusion from OPEC quota (by informal agreement) has worked well so far, and (ii) since the main producers of condensate were countries with large population, low per capita income and large capital needs and since the redistribution among members of increased quotas corresponding to condensate output would entail a negligible gain to condensate producers, the risk of OPEC imposing quota restrictions were small. In any case, the Region assured the meeting that an independent expert would provide guidance to the Bank on this particular issue. The Chairman stressed that a key issue was whether existing crude petroleum quotas have been determined by taking into account the existing condensate supplies and whether the newly increased condensate supplies could lead to a future reduction of Nigeria's oil production quota. He suggested that the question of OPEC quota be studied seriously because it will affect the economic justification of the project.

The arrangements that the cofinanciers are seeking -- the escrow account, preferred creditor status with respect to the Paris Club rescheduling arrangements and Central Bank's reserve requirements -- were discussed by several speakers. The main questions raised by the Chairman were: (i) by agreeing to the establishment of an escrow account in a country that faces a tight balance of payments situation, do we not imperil our own situation? (ii) will it not encourage other creditors to seek similar arrangements for other projects in Nigeria and in other heavily indebted countries? and (iii) will the IMF agree to these arrangements?

The Region's judgement was that since the project was likely to generate net additional foreign exchange of about $13 billion over the 25-year period, it should enhance the country's capability to service other debts - including those of the Bank. The Region also stated that this subject has been broached with the IMF which would most probably approve the arrangements with some safeguards, although the final IMF position was yet to be ascertained. The Region further stated that almost all the potential creditors have told Mobil that without an escrow account and without the Bank Group's presence, their participation in the proposed operation would not materialize. The Region was confident that Nigeria's other creditors would look favorably at the possibility of waiving their negative pledge clause for the OSO project assets, but felt that it was unlikely that Central Banks would waive reserve requirements. The IFC representative also stressed that IFC could not proceed without an escrow account and IFC experience with escrow accounts elsewhere has been positive. The Legal Department did not foresee any problem with the establishment and operation of an escrow account if that was deemed necessary. The IFC representative also proposed that if the Committee would agree, IFC could itself take the initiatives in seeking exemption from the debt rescheduling arrangements and reserve requirements with respect to the OSO Field Project. The Chairman observed that if new loans to the proposed project could be obtained on terms which were sufficiently long then it might automatically be left out of the Paris Club rescheduling.

The Chairman and another member also stressed that if the special arrangements were feasible and overall net benefits and cash flow were so obvious and sizable, the more comfortable arrangements were obtained, the less persuasive became the case for Bank participation in the project. In any case, the Chairman felt that it was critical that country moves on the required macro policies and structural adjustment and that the rest of Bank's relations with Nigeria should shape up as envisaged.

The Region informed the Committee that the Project management would be handled by Mobil and, after some initial hesitation, they are prepared to follow Bank guidelines with respect to procurement procedures. The meeting was also informed, by the IFC representatives, that there was need to move with some caution in dealing with Mobil because they are also reported to be following a parallel track of contractors' financing without Bank Group involvement. Therefore, it was necessary to ensure that the Bank/IFC are not used by Mobil simply to get concessions for the project from third parties.

The Chairman concluded the meeting by summing up (i) a healthy financial structure for the project should be established, (ii) the Bank's involvement will make sense only if the country also moves on some of the key macropolicy and structural adjustment issues; (iii) the case for the full range of special arrangements (escrow account, exemption from debt rescheduling/reserve requirements etc.) has to be re-examined and finally (iv) the IFC should take the lead role in steering critical parts of the project (such as on credit enhancement questions) with the Bank performing the roles that others cannot do reasonably well.

EG
FMChaudhri:EGrilli/gs
August 18, 1988

The World Bank
OPERATIONS COMMITTEE

CONFIDENTIAL

MEXICO

COUNTRY STRATEGY PAPER

Postscript

92. The Operations Committee met on August 9, 1988, to consider the Country Strategy Paper for Mexico which proposed an annual lending program of up to $2 billion for the period 1988/89-93. The discussion followed the Agenda prepared by the Economic Advisory Staff. The principal issues were related to macroeconomic performance and prospects, risks and downside scenarios, financing prospects, and the lending strategy.

93. In its opening remarks the Region reported on recent events in Mexico. The Government's austerity program was progressing well, monthly inflation in July being 1.7% compared to 15.5% in January. But the country is in transition from a strong presidential system to an as yet undefined form of power sharing. Despite strong promises of continuity from de la Madrid and from the President-elect, the austerity program can easily be jeopardized. The Region also reported that the Bank's relationship with Mexico continues to be close. A series of policy papers is being prepared to engage the new administration in policy discussions and to gear up for sustained lending at a high level.

Macroeconomic Issues, Risks, and Financing

94. The Chairman invited comments on the base and low case macro-scenarios and the policy packages that correspond to them. He questioned the viability of the low case as well as the financing plans for the two scenarios--especially the variations assumed in the Bank's lending, direct foreign investments and commercial bank lending. The Region explained that the base case meant staying the course and deepening reforms on prices and regulations, removal of entry barriers, and reforms in the special sector programs and in parastatals.

95. A speaker enquired about the causes of Mexico's inflation. The Region explained that historically inflation in Mexico has had a demonstrable fiscal origin, but by now a significant inertial element has been added. Because of this inertial element a program based only on fiscal and monetary policy would be too recessionary. The anti-inflation program therefore includes a freeze of the key nominal "anchors" (minimum wages, prices of the basic consumption basket, and the nominal exchange rate). The Committee also questioned why the macroeconomic adjustment for the base scenario showed such low non-oil export growth as, for instance, only 1.9% in 1988. The Region acknowledged that while the behaviour of non-oil exports in 1988 is likely to be adversely affected by the expected real appreciation of the exchange rate, nonetheless, the assumed growth for 1988 is conservative given the rapid expansion of those exports during the first five months.

96. Another Committee member asked about the Government's strategy for getting out of the "freeze." He felt that there was a very clear danger that if the freeze became prolonged then a sharp devaluation, and an associated burst of inflation, would become inevitable. The Region explained that some adjustments in wages and public sector prices are likely to occur after the presidential address scheduled for September 1. As for the exchange rate level, this was to be expected only at a later date. However, given the depreciated exchange rate levels before the "Pacto," there is still some room for appreciations before the rate becomes badly out of line.

97. The Chairman said that despite very good progress in trade liberalization, the Mexican economy remained highly inefficient and overregulated; the potential for growth would be realized only if strong measures were taken to improve productivity, efficiency and exports. Export-led growth would be particularly important because Mexico's public finances could not sustain a return to higher domestic spending. These links between policy actions and the projections needed greater emphasis. The low-case scenario presented in the CSP was also considered unlikely, its purpose being to illustrate the fragility and the high risks of the Mexican situation rather than a genuinely viable alternative. A speaker suggested that a more realistic downside scenario might be a "dash for growth" strategy that reverses the austerity program as well as the trade liberalization measures. In response the Region said that while such a downside scenario could not be ruled out, one must also note that a growing constituency has emerged, led by successful exporters as well as well-trained policymakers, that represents a "coalition for change." This coalition reduces the likelihood of major departures from the de la Madrid policies.

98. In response to questions on the assumed level of direct foreign investment in the projection period, the Region explained that the projected values would imply a ratio of between 1.1% and 1.2% of GDP, compared with ratios that have ranged from 0.9% of GDP to 1.1% between 1968 and 1986. Furthermore, the assumed rate of growth of such investments is about 4.8% each year in dollar terms. This is about the same as the projected growth of OECD countries in dollar terms (2.6% in volume terms and 2% in the dollar-denominated inflation rate). No new debt-equity swaps would be necessary to justify the assumed growth in foreign investments. The Region emphasized also that the "maquila" industry and the common border with the US made Mexico a particularly attractive candidate for foreign investments.

99. In concluding this part of the discussion, the Chairman said that the overall financial situation in Mexico is going to be very strained, with heavy dependence on external capital. Mexico's success with trade liberalization must be broadened and deepened to emphasize productivity and export-increasing policies. Our policy advice and operations should directly address the need for deregulations. Deregulations should enhance confidence abroad and encourage foreign investments. He noted also that at the present time there is no overall scheme for debt reductions--the specific scheme described in the CSP did not have the necessary support of governments.

Lending Strategy

100. Questions were raised about the feasibility of the $2 billion dollar lending program. The Region responded that 1989 will be a slow year, with new commitments in all likelihood remaining within US$1.3 billion, but Bank lending should pick up in 1990 and beyond. With good Mexican policies, the Bank can easily lend more. The Chairman commended the Region for its initiative in preparing a set of policy papers for discussions with the incoming administration and hoped that they would facilitate an adequate lending effort. It was also suggested that the Bank's dialogue give special emphasis to the "defreeze" issues, in particular on the need for realistic exchange rates.

101. In closing, the Chairman said he had no objections to the proposed 75% cost sharing for social projects, provided the Bank's average cost sharing on a country-wide basis remains within 50%. He recommended that the paper be revised to reflect the various suggestions prior to submission to the President.

MMartinez/ARay:vlw
August 15, 1988

The World Bank/International Finance Corporation
O F F I C E   M E M O R A N D U M

DATE: 9-Aug-1988 09:41am

TO: Moeen A. Qureshi (MOEEN QURESHI)
TO: Vinod Dubey (VINOD DUBEY)

FROM: Rainer Steckhan, LA2DR (RAINER STECKHAN)

EXT.: 38074

SUBJECT: **MEXICO - CSP Update**

Here are some additional points:

(a) In an important weekend speech President de la Madrid ruled out a unilateral moratorium on external debt;

(b) In the same speech President de la Madrid ruled out spectacular actions on domestic policies--continuity is the name of the game;

(c) The fight against inflation will remain No. 1 priority (July inflation estimated at 1.5% with the second half of July being 0.2%);

(d) Debt reduction will continue to be high priority but probably unfeasible before the new Government takes over on December 1, 1988.

CC: Miguel E. Martinez (MIGUEL E. MARTINEZ)

The World Bank/International Finance Corporation
O F F I C E   M E M O R A N D U M

DATE: 9-Aug-1988 01:13pm

TO: Rainer Steckhan (RAINER STECKHAN)

FROM: Dennis Flannery, DFS (DENNIS FLANNERY)

EXT.: 72657

SUBJECT: **Mexico**

I spoke with a couple of very well-informed contacts this morning on the subject of Mexico, and was assured that we are unlikely to read any announcement in the next weeks about a dramatic development on the debt front. I was told that the Government continues to evaluate numerous proposals from commercial banks and investment banks, some of which have merit, if only in part. The Government is set on the idea of debt reduction as opposed to new money; and it is certain that there will need to be some credit enhancement on interest payments in order for a deal to really succeed. The idea of bilateral support of a World Bank insurance scheme is still considered to be alive. I was told that mid-Fall is a more likely launch date than mid-August. The core team continues to be Morgan Guaranty, Cleary Gottlieb and Angel Gurria.

CC: Moeen A. Qureshi (MOEEN QURESHI)
CC: David R. Bock (DAVID BOCK)

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: August 5, 1988

TO: Mr. Moeen A. Qureshi

FROM: V. Rajagopalan VR

EXTENSION: 33419

SUBJECT: MEXICO - Country Strategy Paper

1. I will not be able, unfortunately, to attend the Operations Committee meeting next Tuesday.

2. In addition to other issues which I assume the Committee will take up regarding lending strategy, Mexico's creditworthiness and so on, it seems to me that the latest Mexican proposal for debt reduction (para. 64) raises questions about policy on the use of the Bank's guarantee for interest payments by Mexico. I am sure that the Committee will consider this issue.

cc: The Operations Committee.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

880804023

DATE: August 4, 1988

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78051/2

SUBJECT: MEXICO - Country Strategy Paper - Agenda

1. The Operations Committee will meet on Tuesday, August 9, 1988 at 3:00 p.m. in Room E-1243 to discuss the Mexico Country Strategy Paper.

Introduction

2. Since the onset of the debt crisis in 1982, Mexico has shown considerable resolve in sustaining its efforts at stabilization and adjustment. But contractionary policies have resulted in little growth over this period. Per capita incomes are lower now than in 1981; moreover investments have fallen - the investment ratio was 29% in 1981 but now it is less than 20%.

3. Despite the sacrifices in current and future real incomes, the stabilization process has not worked smoothly. The results of the first phase during 1983-84 were largely negated by policy slippages and lack of progress toward structural reform. The restoration of stabilization measures in late 1985 and 1986 did not reduce inflation, which accelerated during 1986 and 1987. The economic Solidarity Pact of December 1987--which included wage-price-exchange rate freezes--represents yet another attempt to stabilize the economy. Thus far it has progressed well. As of June, the primary surplus had risen to an estimated 8.4% of GDP, compared to 6.4% in the first half of 1987, and the monthly rate of inflation is currently only 2%, compared to 15.5% in January. But the question of how Mexico can combine growth with stability is still very much open.

4. A remarkable feature of Mexican policies during this period has been its sustained commitment to trade liberalization since 1985. NTB coverage has been reduced to about 23% of 1986 production and the maximum import tariff is now 20%. The second tranche release of TPL II is shortly expected. Non-oil exports have been responsive to macro-policies, especially to the real exchange rate, and will, no doubt, benefit further from the liberalization of the trade regime. To be fully effective, however, the trade reforms need to be accompanied by reforms of the numerous price controls and regulations within the economy. The challenge today is not just to prevent policy reversals but to design and implement a broad program of policy changes throughout the economy to help increase efficiency and growth.

Macroeconomic Issues, Risks and Financing

5. This CSP sets out the many complex issues in Mexico with great care and clarity. The Committee might focus on the content and priorities of the necessary policy reforms and on risks. The two scenarios may be

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SVPOP

usefully referred to in this context. The Region might elaborate upon:

- the "core" macro and sectoral policies necessary to produce the base scenario, which assumes a smooth stabilization process with a steady-state inflation rate of only 15%. Is there a coherent reform program that would build on the momentum of the past reforms? If so, what are the priorities? While domestic price decontrols and deregulations are referred to in general terms, there is surprisingly little mention of the need for overall tax reforms;

- the reasonableness of the base scenario as an anchor for designing Bank strategies. The scenario raises several concerns: (a) past history suggests it is unrealistic to assume smooth convergence to steady state; (b) the assumption that direct foreign investments (DFI) will take up some two-thirds of net financing needs (p.17) is not strong (para. 62); and (c) the assumption that commercial banks will effect net transfers of $2.3 billion may also be questioned. These concerns, which are rightly highlighted in the CSP, suggest that concerted lending, new money packages, and debt reduction schemes will in all probability continue to be needed even if policy reforms proceed at a fast pace;

- what the Bank might be able to do to assist Mexico in its efforts to devise and implement debt reduction schemes, including the new credit enhancement scheme discussed in paragraph 64.

6. Mexico has a high risk rating (IIIb), although the Bank's standard exposure ratios are expected to remain within guidelines. The riskiness of the situation is not fully captured by the base and low scenarios since they differ solely with respect to domestic policy slippages. Both scenarios are "knife-edge" equilibria that can be easily disturbed by a combination of adverse external and internal events. The Committee might wish to consider:

- the reasonableness of the low case as a basis for contingency planning. This case is presented as a viable "muddling-through" equilibrium with a constant inflation rate of 120%, but it is doubtful that stability can be sustained that way. Questions arise regarding the willingness of the IMF to consider a Stand-by without prospects for improving macro performance, the likelihood of commercial banks coming up with net transfers of $3.9 billion, and the likelihood of DFI again filling two-thirds of the gap.

Lending Strategy

7. The strategy proposed in the CSP is one of committing $2 billion per year in the base case, $0.9 billion per year in the low case, or somewhere in between depending on actual policy performance. The low case will have no policy-based loans, the program shown being the fall-back, or "core," lending program. There is little difference between the two cases in terms of the year in which net transfers become negative. The onset of negative net transfers is postponed by only one year if the higher lending program is chosen (to 1991, attachment 8), due to the fact that we have a maturing lending program in the country (attachment 7, page 5, table 2).

It is noteworthy that the expanded program is quite close to the May 1988 program (except in 1992). The Region might comment on: ?

- the extent of policy-based lending required for maximum leverage on the "core" set of policy reforms. While the CSP justifiably stresses the importance of "strict" macro and sector conditionalities (to contain Bank risks, para. 90), it is not clear that the number and timing of policy-based loans will give us enough leverage;

- the two new areas of involvement in the proposed lending program, viz (i) the financial sector in which the Government had been reluctant to get the Bank involved, and (ii) the social sectors; Keep country amount 50 %?

- the justification for increasing project cost sharing to 75% in the social sectors and in selected high priority investment projects (p.87). This relaxation seems unwarranted because the Government should be able to assure counterpart funding in projects that are clearly of high priority. Overall cost sharing should remain what it is now

cc: Messrs. Lee, COD; Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Burmester/Thahane, SEC; Baudon, SVPOP; Selowsky, Steckhan, Martinez, Varallyay, LAC.

For Information

cc: Messrs. Hopper, SVPPR; Bock, DFS; Goldberg, VPLEG; Frank, Parmar, Pfeffermann, IFC; Baneth, IEC; Aguirre-Sacasa, EXT; Tanaka, (Ms.) Haug, EXC; Robless, OPNMS.

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vlw

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Enclave project.

Catalytic role.

Export Credit Agencies

Basically the equity

Not subject to OPEC

Financing Plan to be needs [illegible]

DATE: August 5, 1988

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS V. Dubey

EXTENSION: 78051

SUBJECT: NIGERIA: OSO Condensate Field Development Project (Agenda)

1. The Operations Committee will meet on Tuesday, August 9, 1988 at 4 p.m. in Conference Room E-1243 to discuss the above-mentioned project. An Executive Projects Summary was prepared on the project which is included in the package distributed by the Region.

2. The total project cost is expected to be around US$900 million of which the Bank is estimated to provide $200 -$250 million and IFC about $60 million. The Region proposes to process the project as a joint World Bank/IFC project. IFC has already presented this project to its Investment Committee for an initial project review. A joint pre-appraisal mission is scheduled for September 1988 and tentative appraisal date is April 1989. Prequalification documents are expected to be ready by about September 1988. Bids are expected around February 1989 with awards around April/May 1989.

3. The key issues in Mr. Jaycox's memorandum that the Committee might wish to discuss are:

(1) Prospects of condensate supply and OPEC Quota stance;

(2) Completeness of the financing plan, and the Bank's catalytic role;

(3) Probable structure of the escrow account for debt servicing out of project revenues; the IMF position and Cofinancing arrangements;

(4) Prospects of obtaining exemption for OSO debts from future Paris Club Rescheduling and the Bank/Fund support for these arrangements;

(5) The Bank/Fund role in securing exclusion of commercial bank lending to OSO from reserve/provisioning requirements of the central banks;

4. In addition to the above-mentioned issues the Committee might also wish to discuss the following three issues:

(i) How the proposed project fits into the country assistance strategy;

(ii) How the project is likely to resolve the key issues faced by the energy sector in Nigeria;

(iii) Is the proposed project fully consistent with the Proposed Procurement Procedures for Petroleum Joint Ventures?

5. Finally, the Committee might also discuss an IFC request that the Bank agree to a cross-default arrangement whereby certain events of default under the IFC Investment Agreement (for example, termination or unilateral amendment by Government/NNPC of Mobil's escrow account arrangements or its role as project operator) would also constitute defaults under the Bank's own documentation, and vice versa.

cc: Messrs. Lee (COD), Shakow (SPR), Liebenthal (SPRPA), Holsen (CEC)
Rao, Steer (FRS), Baudon (SVPOP), Burmester/Thahane (SEC),
Hopper (SVPPR), Bock (DFS), Goldberg (VPLEG), Frank (CFP),
Parmar (CIO), Pfeffermann (CEI), Baneth (IEC), Tanaka (EXC),
Robless (OPNMS), Agarwala (AFRCE), O'Brien (AFRCE),
Denning (AFRVP), Koch-Weser (AF4DR), Alizai (CA2DR),
Mante (CA2DR), Aiyer (AF4IE), Adams (AF4CO), Squire (AF4CO),
Mss. Haug (EXC), Salop (AF4CO)

FMChaudhri:gs

August 4, 1988

Mr. Qureshi

2.

The World Bank
OPERATIONS COMMITTEE

Minutes of Operations Committee to Consider
Honduras - Structural Adjustment Loan-Initiating Memorandum

Held on August 4, 1988 in Conference Room E-1243

A. Present

Committee		Others	
Messrs.	M. Qureshi (Chairman)	Messrs.	V. Dubey (EAS)
	H. Vergin (SVPOP)		A. Ray (EAS)
	P. Hasan (EMNVP)		L. Derbez (LA2CO)
	O. Yenal (ASIVP)	Ms.	C. Sepeda (LA2CO)
	H. Scott (VPLEG)		J. Garcia-Mujica (LA2CO)
	E. Wessels (LACVP)	Ms.	M. Garcia-Zamor (LACVP)
	D. Rao (FRS)		R. Cucullu (LEGLA)
	A. Gelb (CECFP)		D. Martinusen (IFC)
	M. Gillette (AFRVP)		F. Kilby (FRS)
			K. Siraj (COD)
			C. Robless (OPNMS)
		Ms.	C. Mann (VPDEC)

B. Issues

1. The meeting was called to consider the Initiating Memorandum for a proposed Structural Adjustment Loan to Honduras. The discussion mainly followed the agenda prepared by the Economic Advisory Staff.

C. The Discussion

2. The Chairman opened the meeting by asking for an explanation of the urgency of the proposed adjustment program and the constraints on its design. In response the Region first provided some background on the current situation, explaining that the generous support which both multilaterals and bilaterals made available for large investment programs in the 1970s and 1980s has dwindled. In particular, the completion of the very large El Cajon project, revenues from which have fallen far short of expectations, has greatly reduced capital inflows. While bilateral grant assistance had permitted the country to defer the necessary macroeconomic adjustments, all economic groups including important private sector groups, have come to recognize that significant changes are needed.

3. The Region then added that the adjustment program being discussed with the Government is a multi-year program, with several major areas of focus. The Initiating Memorandum, however, concentrated on the 1988 program which, in isolation, may appear thin. The goals of the medium-term program being discussed included reductions in public deficits, reforms of public enterprises, unification of exchange rates, and reforms of trade and agricultural policies. The Region would also be designing a program of reforms to improve the strength of the financial system as well as the efficiency of credit allocation.

4. The Chairman asked why a phased approach to exchange rate changes was being proposed. He also questioned the soundness and the credibility of the proposal, which appeared to be make-shift in nature. Another member said that we would not be consistent if we accepted national pride as a constraint on exchange rate changes; it was suggested also that the proposed measures would not amount to a 30 percent real devaluation as indicated. The Region explained the scheme and the calculations, and added that the fundamental reason for the proposed approach was the political resistance to outright devaluations. The proposed approach would involve de facto devaluations through an indirect, multiple exchange rate mechanism, which, though complicated, would ensure an orderly transition to an eventual unified and flexible system, and allow more time for the development of a dialogue.

5. A Committee member asked why the IMF was not involved directly in the program; was it only the arrears, or was the IMF's assessment of the program different from the Bank's? Another member said that there appeared to have been substantial macro actions thus far during 1988, although not much was being proposed for the last quarter. He also said that the financing plans in the paper appeared inconsistent and confusing. Another speaker commented on the financial risks attached to the proposed strategy, noting that the Bank's exposure ratios in Honduras were well beyond the guidelines. He added that concentrating solely on adjustment loans would be unwise and that a Country Strategy Paper should be prepared soon to clarify strategies in terms of exposure and policy lending.

6. In response, the Region said that it had been led to believe that the IMF would agree to a stand-by as soon as its arrears were cleared; the targets being proposed had been endorsed by the IMF at the working level. On the macroeconomic actions thus far in 1988, the Region said that this had been in part due to the Bank's dialogue with the Government since March. The monetary control measures had taken effect, and fiscal expenditure reductions had been decreed. Only the exchange rate actions were lagging. With respect to the financing plan, the Region had assumed rescheduling of nearly all external debt with commercial banks. Finally, on exposure ratios, the Region said that this issue had to be seen in terms of a with- and without-lending comparison; not lending would not lower exposure--it would simply mean that the Bank would not be paid.

Decisions

7. The Chairman said that the Bank's ability to lend would depend on the Government's performance. The Government would have to agree to take decisive actions to improve its debt servicing capacity. Secondly, he emphasized the desirability of reaching an agreement with the IMF on an adequate macroeconomic framework as soon as possible. Thirdly, he urged the Region to push hard on the exchange rate issue. Policy actions under the program, especially on exchange rates, would have to be decisive, clear-cut and also quicker. He also urged that the medium-term objectives and the actions necessary to reach them be very clearly defined in the next round of documentation.

Sepeda/Ray:cpf
August 8, 1988

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 29, 1988

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78051/2

SUBJECT: HONDURAS: Proposed Structural Adjustment Loan Initiating Memorandum - Agenda

1. The Operations Committee will meet on Thursday, August 4, 1988 at 3:00 p.m., in Room E-1243 to consider the IM for a Structural Adjustment Loan to Honduras in the amount of $50 million. The Region intends to present the loan to the Board on September 15. Two equal tranches are proposed.

2. This would be the first adjustment loan in Honduras. It is intended to be a part of a larger effort in coordination with other donors to clear arrears to the Bank and IMF, prevent increases in arrears to others, and to set Honduras back on a path of growth with stability. The SAL is to be followed up with a sequence of SECALs (paragraph 54).

Issues

3. The first set of issues concerns the political feasibility of structural adjustment in Honduras and the medium-term policy framework. The current administration only has one-year left and it has been significantly weakened by the Matta affair and by the change in the leadership of the Economic Team. The Government's commitment to a medium-term adjustment program is therefore open to question. Furthermore, no medium-term framework is presented in the IM, and no indications are given of the type of Development Policy Statement that we can expect. The Region might comment on the political situation and on the feasibility of a meaningful agreement on a medium-term framework.

4. The second set of issues concerns program design and the coordination between the Bank and the IMF. The Region might elaborate upon:

- public finance conditionalities. In particular, (i) what precisely are the conditions we should aim at; the ones in the matrix seem broader than the ones given in paragraph 63; (ii) is it reasonable to expect quick improvements in income tax collections to any significant degree (matrix); (iii) while removing tariff exemptions would be good from the revenue point of view, it is not obvious that tariff surcharges need also to be eliminated at this time. What are the distortions caused by the surcharges (paragraph 18)?

- trade conditionalities. Other than the elimination of the import surcharges and the removal of exemptions, no other trade conditions are mentioned. Should the mission look into other issues, e.g., export promotion?

- exchange rate. It is proposed to increase the scope of CETRA, and thereby effectively devalue the currency. Currently the coverage of CETRA is 30% for non-traditional exports; it would be 40% under the proposal. Is this a sufficient change? Should we insist on outright devaluations and exchange rate flexibility?

- money and credit. What specific actions are we aiming for on credit subsidies?

- IMF. What is meant by an IMF "shadow" program (para. 67)? Since the type of conditionalities proposed is very similar to stand-bys, and since a stand-by is expected, will there be overlap or conflict? If the program is to be completely "taken over" by the IMF after January, should this loan be thought of as a SAL?

5. Finally, the Committee might wish to consider the financing plans. The Region might elaborate upon paragraph 56, explain the arrears that will not be cleared in the process, and comment on the current understandings with IMF, USAID and other donors.

cc: Messrs. Lee, COD; Shakow, Liebenthal, FRS; Holsen, CEC; Rao, Steer, FRS. Burmester/Thahane, SEC; Baudon, SVPOP; Selowsky, Steckhan, Martinez, Derbez, LAC.

For Information

cc: Messrs. Hopper, SVPPR; Bock, DFS; Goldberg, VPLEG; Frank, Parmar, Pfeffermann, IFC; Baneth, IEC; Aguirre-Sacasa, EXT; Tanaka, (Ms.) Haug, EXC; Robless, OPNMS.

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Why do we have to go through Anything

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Mr. Qureshi

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 25, 1988

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: HONDURAS--Proposed Structural Adjustment Loan Initiating Memorandum

1. Attached for your review and subsequent approval is the Initiating Memorandum for the proposed Structural Adjustment Loan for Honduras. Preparation of the program began in earnest in February 1988, when the Authorities requested Bank assistance to address the financial crisis that began to emerge in 1987. A pre-appraisal mission visited Honduras June 1-17, 1988. At a final meeting with President Azcona, agreement was reached on a policy matrix, attached as Annex 1 of the IM. Since the mission's departure, the monetary measures and expenditure measures agreed have been implemented; the revenue measures are under consideration by Congress. During appraisal, we will give final definition to the specific details of the policy matrix.

Key Adjustment Measures

2. The program for the SAL concentrates primarily on policy actions that address Honduras' short-term macroeconomic imbalances. To address Honduras' structural problems, however, a minimum set of actions designed to trigger a major adjustment program in 1989 were also defined. Thus, key policy actions were concentrated in the following areas: (a) public finances; (b) monetary program; (c) balance or payments; and (d) financial sector.

3. Public Finances. In addition to actions taken in the first half of 1988, the mission estimated that the fiscal program for the second half of 1988 should be designed to reduce the deficit by at least 0.7 percent of GDP; the program for 1989 should aim at a further reduction of 2 percent of GDP. The mission strongly recommended that such reductions be brought about through both a major reduction in expenditures and increased public sector savings. Agreement was also reached to prepare a program for the restructuring and adjustment of the major public enterprises, in parallel with the program for adjustment and restructuring of ENEE (the electric power company). The target for presentation of the operations is late FY89.

4. Monetary Program. With the support of the IMF mission, which was in the field at the same time, a monetary program was prepared defining ceilings for total credit to the public sector, accumulation of net external reserves, and total credit to the economy. The IMF has established a shadow program on the basis of the same targets. If our SAL proceeds satisfactorily, and provided that arrears to the IMF are cleared, a strong possibility exists for a Stand-by in early 1989.

5. Balance of Payments. A critical element for the long-term success of the adjustment program lies in the equilibrium of the current account (CA), but Honduras' exports have only limited prospects for further growth under the current exchange rate and trade regimes. In the short term, the CA deficit should fall to an amount that could be financed with available external financing from bilateral and multilateral agencies, or no higher than 3 percent of GDP in 1988 and 1989. The Government is defining a program to increase flexibility in the management of the exchange rate, which the Bank will evaluate during appraisal. Agreement was reached in defining actions to: (a) reduce the spread between the official and parallel market rates (currently at 40-50%) to no more than 20 percent; (b) provide exporters with a transparent and more efficient exchange rate system; and (c) eliminate the numerous tariff exemptions and surcharges, thus reducing the average level of effective protection in the trade regime. The Government also agreed to prepare during 1988 a study to define needed reforms of the current tariff system. This study will serve as the basis for discussions on the adjustment program for 1989.

6. Financial Sector Reforms. A monetary program with quarterly targets for total credit and credit to the public sector was defined. Due to the severe limitations on access to foreign savings, credit to the private sector will also be restricted during 1988, despite the reduction in credit to the public sector. Given the urgency for measures in the fiscal, monetary, and exchange rate areas, discussions on structural reforms in the financial sector were necessarily of a more limited nature, but progress was made in discussions on the unification of interest rates on Central Bank credit lines to reduce credit subsidies and encourage banks to mobilize resources, as well as in implementation of an ongoing technical assistance effort to strengthen the supervisory capabilities of the Superintendency of Banks and to review the banking legislation with a view to enhancing the Superintendency's regulatory powers. Discussions were carried out regarding measures needed to: (a) increase domestic savings and improve their allocation in the economy, which will be crucial to the success of the medium-term adjustment program; and (b) strengthen the financial viability of financial sector institutions. The mission considers that further action to carry out such measures can wait until the next phase of the adjustment program in 1989.

Status of IMF Dialogue

7. As mentioned above, the IMF has agreed with the Government on a shadow program, with monetary and fiscal targets for the last half of CY88. Provided the agreed targets are met and arrears are cleared, the IMF will proceed to negotiate a formal Stand-By Arrangement, to be based on the continuation of the adjustment process through 1989. Formal negotiations are possible by late October, but more likely for November. In spite of the constraints imposed by the problem of arrears, IMF staff have maintained close informal contact with the Authorities, and have cooperated closely with Bank staff in defining the macroeconomic adjustment measures included in the program. The timing of clearance of arrears to the IMF is likely to be a key variable in finalizing a viable financing plan for the country for 1988 (para. 11, below).

Coordination with USAID

8. USAID has played a supportive role in the process of design and negotiation of the program. It has also established as a condition for release of the first tranche of ESF funds for 1988 Government compliance with the Bank's conditions for Board presentation of the SAL, thus increasing our leverage at a critical stage. USAID headquarters in Washington has informed us that approval of the simultaneous release of the first and second ESF disbursements in August is likely, which will be key to the success of the financing plan (para. 11, below). We will keep you informed of developments as the financing plan is completed.

Financing Plan

9. Scarcity of foreign exchange remains dramatic. The Government has been unable to service its debt with the Bank, IMF, IDB, bilateral agencies or commercial creditors. As of June 15, 1988, total accumulated arrears amounted to about US$200 million, of which US$26.5 million was due to the Bank, US$16 million to the IMF, and US$15 million to the IDB. Bank disbursements were suspended on the same date, when about US$17.4 million became 75 days overdue. Assuming no payments before September 1, 1988, total service payments due to the Bank and IMF would amount to about US$ 70 million; payments due to bilateral agencies would total an additional US$ 15 million.

10. Clearing arrears to the Bank of more than 30 days was defined by the mission as a precondition for presentation of the SAL to the Bank's Board. The mission discussed with the Authorities the key variables affecting the financing plan for the year, as well as the options that may be available to complete the plan. It is clear that, given the current foreign exchange shortage, the Government cannot pay the overdue amounts before the scheduled Board date without some external assistance. This, in turn, will require close donor coordination. We have discussed the situation thoroughly with IMF and USAID staff, as well as with representatives of the US Treasury and State Departments and the US Executives Directors offices at both the IMF and the Bank. Proposals were subsequently submitted to the corresponding US agencies regarding the importance of US support to the viability of a financing plan and, consequently, to the success of the program itself.

11. We have now been informed by the US Executive Director's office that the US Government will support a financing plan based on: (a) full clearance of arrears to the Bank by mid-August; (b) release of the first two tranches of USAID ESF funds in August (rather than delaying one disbursement until October); and (c) full clearance of arrears with the IMF by the end of 1988, but not before Board presentation of the SAL. On this basis, additional bridge loans may not be necessary. However, the Government has discussed this possibility with a number of Central Banks, including the Central Bank of Mexico, which responded positively. Provided that disbursements are made as planned and the cofinancing expected from OECF materializes (see para. 12, below), the financing plan for 1988 would be complete.

12. Cofinancing Possibilities. The pre-appraisal mission discussed with the authorities the possibility of obtaining cofinancing for the SAL.

President Azcona agreed to the Bank's exploring such a possibility with the Government of Japan and friendly countries. Japan has informally expressed interest in providing cofinancing for the SAL in an amount equal to the Bank loan through OECF. We have initiated the formal process of enquiry through Mr. Ishikawa, with the assistance of Mr. Inakage's office. We await a response and are prepared to provide the Japanese Government with whatever information is necessary to facilitate a quick decision on the needed cofinancing.

13. Discussions were initiated at a meeting during the Costa Rica Consultative Group meeting held in Paris on June 27 and 28, 1988, attended by representatives from the Governments of Canada, Germany, Italy, Japan, Netherlands and United States, and of the EEC and UNDP. Although lukewarm, the support expressed gives us hope of finding cofinancing for Honduras' adjustment program either during CY88 or, more probably, CY89.

Risks

14. The difficult political situation in Honduras, which weakens the hand of the President, heightens the risks associated with the proposed adjustment and lending strategy. The increase in terrorist activity since the extradition of Matta Ballesteros and the burning of the US Embassy Annex has disturbed the relatively peaceful equilibrium that Honduras has enjoyed and adds to the Government's own perception of the political risk of adjustment. Further, the Government is nearing its last year in office, which increases the importance of seeking consensus for its policies--a difficult and time-consuming process.

15. On the positive side, the financial crisis facing the country has become apparent both to political leaders and to the private sector, raising their awareness of the need to undertake the agreed reforms quickly. Their concern has led to increased willingness to accept measures they would otherwise resist, providing the Government (and the Bank) with a window of opportunity to enact the adjustment measures in the next few months. Provided the proposed financial support from external donors materializes according to the proposed schedule, the support of important groups can be consolidated, giving continuation of the adjustment program through 1989 and beyond a good chance of success. Therefore, we believe the risks are manageable. Further, since the proposed disbursement schedule would result in only negligible increases in Bank exposure in 1988-89, we believe that the benefits to be gained from going forward with support for the adjustment effort justify the risk.

Processing Timetable

16. Given the importance of the SAL to the Honduran Government, we propose to follow a tight and accelerated schedule. Therefore, we would like to request review of the Initiating Memorandum by the Operations Committee on August 1, 1988. A mission is ready to depart for Honduras on August 8 to appraise the Government's program. We propose to prepare the loan documents for distribution to the Board by end-August, in order to maintain the current Board date of September 15, 1988.

Attachment

Distribution:

Outside the Region		Within the Region	
Messrs.	Shihata, VPLEG	Messrs/Mmes.	Steckhan, LA2DR
	Jaycox, AFRVP		Selowsky, LACVP
	Thalwitz, EMNVP		Wessels, LACTD
	Karaosmanoglu, ASIV		Quijano, LACVP
	Wood, VPFPR		Linder, LACVP
	Rajagopalan, VPPRE		Dolenc, LACVP
	Inakage, VPCOF		Martin, LACVP
	Dubey, EAS (3)		Segura, LACVP
	Baneth, IEC		Garcia-Zamor, LACVP
	Holsen, CEC		Lee, LA2DR
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	Bock, DFS		Binswanger, LA2AG
	Lee, COD		Halperin, LA2IE
	Ludvik, VPCOF		Knotter, LA2TF
	Shakow, SPR		Jones, LA2IE
	Collell, LEGLA		Derbez, LA2CO
	Cucullu, LEGLA		Garcia-Mujica, LA2CO
	Parmar, CIOVP, IFC		Rosenblut, LA2CO
	Jones, CLIE, IFC		Vandendriessche,LA2CO
	Linde, IMF		Sepeda, LA2CO

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August 3, 1988

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The World Bank
OPERATIONS COMMITTEE

Minutes of the Operations Committee Meeting to Consider
COTE D'IVOIRE - Country Strategy Paper

Held on August 3, 1988 in Room E-1243

A. Present

Committee	Others
Messrs. M.A. Qureshi (Chairman)	Messrs. P. Landell-Mills (AF1CO)
M. Gillette (AFRVP)	R. Westebbe (AFRDR)
O. Yenal (ASIVP)	P. Clawson (AF1CO)
P. Hasan (EMNVP)	A. Benbrahim (AF1CO)
R. Martin (LACVP)	D. Singh (AF1DR)
H. Scott (VPLEG)	S. O'Brien (AFRVP)
V. Thomas (VPDEC)	M. Guerard (AFRCE)
H. Vergin (SVPOP)	K. Cleaver (AF1AG)
D. C. Rao (VPFPR)	M. Wormser (AF1IE)
	C. Scoseria (AF1CO)
	L. Robless (OPNMS)
	O. Rahkonen (SECGE)
	V. Dubey (EAS)
	U. Thumm (EAS)
	R. McPheeters (FRS)
	D. Lee (COD)
	K. Siraj (CODOP)
	J. Shilling (DFS
	P. Lietard (IFC)
	I. Christin (IFC)
	P. Dhonte (IMF)

B. Issues

1. The meeting was called on the CSP for Cote d'Ivoire. The discussion mostly followed the agenda prepared by the Economic Advisory Staff. It focused in particular on two major themes: the assessment of the viability of Cote d'Ivoire's current "second-best" strategy and the management of Bank exposure risk (with a number of sub-themes).

Second-Best Strategy

2. The Chairman raised the question whether the current second-best strategy, i.e., the use of fiscal substitutes to bring about a change of the real effective exchange rate in the absence of a nominal exchange rate devaluation, was indeed viable. The Region pointed out that the Government, after initial reluctance, was now committed to the strategy and that additional measures were recently taken to make it work better. It was also mentioned that reactions from the private sector were favorable.

However, it was conceded that there were frictions and problems and that additional adjustment efforts were needed (and indeed required by the Bank and the Fund) to make the situation sustainable. The IMF representative said that the standby arrangement was currently inoperative, that the Fund supported the second-best strategy, but that major additional fiscal savings were needed (most importantly through a reduction of the domestic cocoa price) to get the program back on track.

3. Several speakers expressed serious doubts as to the viability of the second-best strategy and questioned whether the Bank should support it, particularly since the projected results (in terms of growth and improved creditworthiness) were not very impressive while the country would be saddled with substantial additional debt. However, during the discussion the Chairman stressed that the Bank supported strategy actually was a mixture of restrictive demand management and fiscal substitutes to a nominal exchange rate devaluation. Without any other option at hand, the question was essentially how much additional adjustment would be politically feasible. This led to the second major theme, the management of Bank exposure risk and the extent of additional adjustment measures to keep that risk within reasonable limits.

Bank Exposure Risk Management

4. The Chairman led into the discussion of the second theme noting that the proposed strategy was not well linked to the different scenarios, that the scenarios failed to capture the most relevant risks, and that a greater domestic savings effort would be needed in the base case scenario. The Region accepted that a greater savings effort (particularly in the public sector) was needed and said that it was in agreement with the Fund's position to request additional savings on the order of CFAF100 billion on an annual basis, an assumption already built into the base-case scenario. The Region also pointed out that a significant reduction in the domestic price of cocoa would be an important step towards that target and was a precondition of the Bank for further processing of the proposed SECALs. The feasibility of additional revenues and further reductions of expenditures (salaries, social expenditures, public investment) was viewed with greater caution. It was also mentioned that, while the President of Cote d'Ivoire was currently not convinced of the need for a reduction in either the cocoa price or civil service salaries, the pressure on the authorities was increasing to mount a strong adjustment program, inter alia, because neighboring countries were following different policies and had more competitive exchange rates.

5. The discussion finally turned specifically to the question of Bank exposure and the proposed increase during the period covered by the CSP. One speaker pointed out that the proposed $1.3 billion lending program was near the upper end of the range currently contemplated without adequate assurances of a strong policy response by the authorities. The Region stressed, however, that new adjustment lending was conditioned on the implementation of specific additional adjustment measures, and the IMF representative reiterated that a re-assessment of the economic situation was planned for October and that he expected the outcome and recommendations to be close to the policy course assumed in the base-case scenario. It was concluded that a well articulated medium-term framework

(with an explicit discussion of risks as reflected in alternative scenarios) was needed to define the Bank's assistance strategy (including the sequencing of specific loans) and to keep the exposure risk within acceptable limits.

Decisions

6. In summing up, the Chairman decided that the CSP needed more work and that before it would be submitted to the President's Council it would be circulated to the OC. He asked the Region to strengthen the CSP along the following lines:

(i) the currently pursued second-best strategy should be more broadly discussed in terms of its objectives, benefits, and actual experience;

(ii) greater fiscal effort (on the revenue and expenditure side) should be incorporated in the base case, to continue the initial CFAF100 billion savings effort as required by the IMF;

(iii) the scenarios should be reworked, eliminating inconsistencies and incorporating other assumptions about policy performance; and

(iv) the lending program should be better linked to the scenarios so as to define it as a flexible response to alternative policy courses and other events, and to set out clearly the Bank's expectations of what was to be regarded as adequate macro-performance.

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August 4, 1988

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

880803010 Mr. Qureshi

OFFICE MEMORANDUM

1.

DATE: August 3, 1988

TO: Mr. Pierre Landell-Mills, Acting Director, AFI

Vinod Thomas

FROM: Vinod Thomas, Acting Director, CEC

EXTENSION: 61530

SUBJECT: Cote d'Ivoire: Country Strategy Paper

The CSP cogently outlines the urgent problems facing Cote d'Ivoire. It, however, needs to bring out more convincingly the adequacy of the program and of the proposed Bank strategy. Two sets of concerns are summarized below, recognizing that what we have is a very difficult situation.

First, it is not clear that the described program can produce the envisaged macroeconomic results. On the external balance, the projected export performance does not seem to be supported by the proposed tariff-cum-subsidy alternative to a real devaluation, even if the former were feasible: a 30 percent tariff increase, for instance, can only be partly offset by increased export subsidies. On the internal balance, the proposed fiscal measures, even if fully implemented, seem insufficient to close the financing gap.

Second, it is not clear how the presently described program, or a strengthened one, will be adequately supported by the proposed Bank's strategy. The link between the macroeconomic improvements and the lending strategy centered around the three proposed SECALs is tenuous. The SECALs, as described, do not appear to contain macroeconomic adjustment measures of significance. At the same time, the sectoral foundation for the agricultural SECAL (for instance, relative price changes in favor of coffee) needs a better rationale, and the Energy and Water SECALs need concrete policy actions.

cc: Operations Committee
Mr. John Holsen, CECDR (o/r)

VThomas:rcs

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

888801030

OFFICE MEMORANDUM

DATE: July 22, 1988

TO: Operations Committee

FROM: Vinod Dubey, Director, EAS

EXTENSION: 78051/2

SUBJECT: COTE D'IVOIRE - Country Strategy Paper - Agenda

1. The Operations Committee will meet on Wednesday, August 3, 1988 at 3:00 p.m., in Room E-1243 to discuss the Cote d'Ivoire CSP. The Committee may wish to discuss the issues identified in the agenda.

Background

2. As a result of inadequate domestic policies, particularly an overextension of the public sector and a distorted incentives structure, and sharply deteriorating terms of trade, Cote d'Ivoire's two decade long relatively successful development streak came to an end at the beginning of the 1980s. Subsequent adjustment efforts met with some initial positive results. However, falling prices for the country's main export commodities, cocoa and coffee, and the decline of the US dollar vis-a-vis other currencies, including the CFA franc which is pegged to the French franc, threw the country into an acute financial and economic crisis. The Government reacted by suspending debt-service payments to its London and Paris Club creditors and by implementing some additional adjustment in the context of a program supported by an IMF standby arrangement, in addition to the Bank supported adjustment process. However, given the severity of the crisis and the scarcity of external financial support, additional adjustment measures are urgently needed and required to get the Fund program back on track and--as spelled out in the cover memorandum to the CSP--to go forward with proposed Bank sector adjustment lending.

3. Against this background, the CSP discusses a moderate stabilization and broad-based adjustment program with projected medium-term economic growth of about 3.5 percent p.a. and diminishing deficits of the public sector and the current account of the balance of payments, yet leaving an external financing gap on the order of $5.8 billion during 1988-92 requiring continuous debt rescheduling and major support from the Bank and the Fund.

4. The proposed Bank assistance strategy would support a broad-based adjustment program, initially focusing on agriculture, energy, and water and then rounding out the adjustment process through a proposed fourth and final SAL. In addition, sector-specific issues would be addressed through a balanced program of project-specific support. The proposed FY89-93 lending program amounts to about $1.3 billion.

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5. The proposed Bank assistance strategy addresses key adjustment and development issues and appears to be well balanced in response to the country's medium-term needs. However, the position regarding the assessment of Cote d'Ivoire's medium-term economic viability and creditworthiness for Bank lending as well as needed safeguards to keep Bank exposure risk manageable is not fully elaborated in the CSP. Moreover, Cote d'Ivoire, in addition to a high interest burden for its external debt (equivalent to more than 7 percent of GDP) faces a similar transfer problem on account of other factor services (worker and profit remittances) which may need to be addressed over the longer run to improve the country's economic viability. Finally, there are some strictly operational issues related to the proposed sequencing of adjustment lending, the size of the SAL, and the proposed cost sharing.

Medium-Term Viability and Creditworthiness

6. The CSP presents a set of medium-term projections assuming the implementation of a number of adjustment measures which would lead to a gradual improvement of creditworthiness indicators, although for the 1988-90 period the current account deficit and the external interest payments in relation to GDP are projected to remain virtually constant at 8 and 7 percent, respectively. In the absence of nominal exchange rate devaluation, the proposed adjustment program foresees a strengthening of fiscal substitutes (import tariffs and export subsidies) as well as greater fiscal austerity. Although the CSP considers a currency devaluation complemented by fiscal restraint the preferred policy course and suggests to pursue the issue with the French authorities and the IMF in a discreet manner, it also suggests (if only by implication) that the proposed second best solution is feasible and would equally lead to the progressive re-establishment of economic viability. Two main questions arise in this context:

(i) The real exchange rate should not only be adequate to re-establish the competitiveness of the tradeable sectors, but help to generate additional exports to compensate for the continued deterioration of the terms of trade and to allow increasing portions of interest payments on the external debt. Is it realistic to assume that import tariffs and export subsidies could be established at the corresponding levels without being fiscally unmanageable and without the risk of major fraud (smuggling, fausses factures)?

(ii) The projections account for additional fiscal adjustment measures required by the Fund which would result in additional public sector savings of CFAF100 billion. This effort is assumed to be a one-time effort generating a constant amount of savings over time, over and above the assumed base-case savings effort. Considering the remaining financing gap, should one not require increasing additional savings efforts to improve fiscal balances faster than now projected? Alternatively, exchange rate adjustment might become indispensable for the rapid improvement of creditworthiness.

7. While the feasibility of the base case that is presented is thus called into question, the two alternative scenarios presented are also questionable. They essentially project the nominal exchange rate (on the basis of projections of the dollar provided by the Bank's Policy Assumptions Committee) and assume that the consequent increase in the financing gap will be met either wholly by additional external finance (Alternative I) or by additional domestic resource mobilization efforts (Alternative II). Among the questions that arise are:

33

(i) is the increased domestic effort assumed in Alternative II feasible? If yes, why is such an effort not assumed in the base scenario to provide a more rapid turnaround than presented? If no, then what is the purpose of presenting the scenario?

(ii) why is the import elasticity with respect to GDP about 1.0 (average 1988-92) in the base case but 2.3 and 3.0 respectively under Alternatives I and II? If the assumed import elasticity was the same (reflecting policy actions), would not the alternative scenarios look quite different and particularly the projection of residual gaps (Table 5)?

8. Current Bank exposure in Cote d'Ivoire is already high. The most relevant indicator, i.e. debt-service obligations to the Bank in relation to the country's exports of goods and services, is projected to reach 7.3 percent in 1988 and, with the proposed increase in Bank exposure (at a rate of about $120 million per year in terms of net disbursements), to peak at 8.2 percent in 1992. Given the country's shaky creditworthiness, the Bank is at great risk. While the CSP spells out a broad-based adjustment program, it does not define clear macroeconomic targets for the next few years which should be met to allow continued Bank lending and thus make the risk of greater exposure more monitorable and manageable. The Region could be asked to prepare such a framework with specific targets (built primarily on greater fiscal effort than now projected) which the lending program could be linked to. In this context, it would also help if more meaningful alternative scenarios than the ones presented were used to give a better sense of the downside risks resulting not only from a different course of exchange rate movement, but also from lower export prices and inadequate domestic policies (lower tax effort, higher agricultural support prices, etc.), particularly given the political uncertainties.

Long-Term Issues

9. The country faces many medium to long-term development issues that seem to be adequately addressed through the proposed Bank assistance strategy. However, in addition to the high interest burden from the external debt, Cote d'Ivoire also faces another serious transfer problem of nearly equal proportion, i.e., high obligation from the pervasive use of other foreign factors of production (workers, paid for technical assistance, direct investment). In 1987, Cote d'Ivoire had a trade surplus equivalent to 11.1 percent of GDP, yet a current account deficit of 6.6 percent of GDP. The question could be raised whether Cote d'Ivoire, with possible Bank support, should not do more to increase the domestic content of value added through long-term human resources development (particularly

management training) and capital market development (including venture capital). In this latter context, the role of IFC could also be explored.

Sequencing of Adjustment Lending, Size of SAL

10. The paper points out that it is "most critical" to liberalize the domestic price system through a gradual phasing out of controlled prices. It also states that the share of government revenue in GDP has been maintained only by increases in rates on a narrow tax base, which has caused the base to shrink, and evasion to increase. A reform of the tax system is thus also crucial. The paper also joints to the importance of reducing current expenditures, the share of which in GDP has been increasing during the period of austerity. Given the current state of the economy and the need to address these key issues, the question arises whether the proposed shift to sector adjustment lending to be followed by SAL IV in FY91 still makes sense. Moreover, the proposed size of the SAL ($200 million) is somewhat on the high side in relation to GDP when compared to similar operations in countries like Chile, Argentina or Brazil.

Public Investment

Rel-cam an Infrastructure constraint

11. Public investment has declined to around 6 percent of GDP (from 15% in 1982) and is stated to be barely sufficient to maintain the existing stock of capital. The paper proposes that the size of the public investment program should be gradually increased. However, there is need for caution in following this objective. Is there no further scope for rationalization of ongoing public investment? Is there an adequate pipeline of high priority projects in infrastructure? Should not priority in this situation be given to rehabilitation, maintenance and small debottlenecking investments instead of new projects?

Cost Sharing

12. The CSP proposes to continue cost sharing at the current level of 80 percent. For a country at Cote d'Ivoire's level of development this is a relatively high percentage, and it is not in line with the macroeconomic adjustment efforts advocated in the CSP.

cc: Messrs. Lee, COD; Shakow, Liebenthal, SPR; Holsen, CEC; Rao, Steer, FRS; Burmester/Thahane, SEC; Baudon, SVPOP; Serageldin, Landell-Mills, Kaps, Ghanem, AFR.

For Information

cc: Messrs. Hopper, SVPPR; Bock, DFS; Goldberg, VPLEG; Frank, Parmar, Pfeffermann, IFC; Baneth, IEC; Aguirre-Sacasa, EXT; Tanaka, (Ms.) Haug, EXC; Robless, OPNMS.

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