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A STUDY: CONDITIONALITY IN THE AGENCY FOR INTERNATIONAL
DEVELOPMENT'S ECONOMIC ASSISTANCE PROGRAMS IN
SIX COUNTRIES

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I INTRODUCTION

The Chairman, House Foreign Affairs Committee, requested a study of the extent and nature of policy conditionality in Agency for International Development (AID) programs. AID considers economic policy reform to be a major objective of its assistance program. AID has set forth guidance on its reform effort in its Policy Paper "Approach to the Policy Dialogue." The paper emphasizes the importance of a sound economic policy environment for the success of AID's program and describes how AID can influence the policy environment through discussions with recipient governments. This process, known as policy dialogue, involves negotiation, compromise, and usually a gradual movement toward a desired policy change. AID officials stated that successful dialogue depends on a number of factors, including a basic commitment on the part of the recipient-government to undertake reform. Also important, according to the paper, is "mutual respect, and familiarity and sympathy for the other party's objectives, possibilities, and constraints."

Through the policy dialogue, AID and recipient countries identify policies which can be addressed through AID's assistance programs. AID may decide to "condition" or tie assistance to specific recipient government actions. The term "conditionality" refers to policies which a donor or lender expects or requests the recipient government to follow or avoid in order to receive the donor's resources.

The limits and shape of AID's conditionality depend on the type of assistance provided. Economic Support Fund (ESF), Development Assistance (DA), and Public Law 480 (P.L. 480) assistance provide opportunities to influence policies. However, the difference in emphasis and scope among the three types of assistance means that each is unique in serving as a vehicle for policy dialogue.

Economic Support Fund ESF assistance is usually provided for the economic stability and development of the economy as a whole. Because its effectiveness depends largely on the soundness of a recipient country's overall macroeconomic policies, there is a natural link between provision of this assistance and policy dialogue on taxation, exchange rate policies, and other macroeconomic issues. ESF can also be used to influence policies in a specific sector, such as agricultural or health policies and can be used to fund development projects. While AID is free to discuss economic policy issues, AID's ability to attach conditions to economic assistance can be constrained because of the presence of overriding political and security interests in a country. AID officials reaffirmed that AID's leverage is not as strong in such countries. Nevertheless, the policy paper states that some current programs show

promise--notwithstanding the security and foreign policy importance of the assistance--in developing a "substantial and useful interaction with the government on policy reform issues." AID officials identified the Philippines as such an example.

A principal element of U.S. macroeconomic conditionality often has required the recipient country to enter into an International Monetary Fund (IMF) arrangement or, if an arrangement is in place, to comply with the performance criteria of the arrangement. The Congress amended the FY 1985 Foreign Assistance continuing resolution and FY 1984 supplemental appropriation (Kemp-Kasten Amendment) to prohibit the withholding of U.S. bilateral assistance from obligation or disbursement "...solely as a result of the policies of any multilateral institution." AID has reviewed its policy and has issued worldwide guidance on the amendment. This guidance emphasizes that the U.S. government must make independent judgments on appropriate conditions to govern particular obligations and disbursements.

Development Assistance DA's sectoral emphasis (e.g., agriculture and human resource development) has a policy component. AID has recently increased the focus of DA on improving host-government economic analysis to support policy change. AID's paper states that negotiations with the host government about a project can be a forum to exchange views on how the economic policy environment may affect a project and can also serve as a vehicle for discussion on broader policy issues. One limit to the use of DA for this purpose can be the relatively small size of the program.

Public Law 480 Since 1967, P.L. 480 food aid has been explicitly linked to developmental objectives. Recently AID has placed greater emphasis on the use of P.L. 480 assistance to promote more effective agricultural and rural development policies. P.L. 480 can serve as a vehicle for discussion of either or both macroeconomic and sectoral policies because it carries general balance-of-payments implications. Title I loans are made on the condition that the recipient countries undertake self-help measures to improve agricultural production and marketing. Title III provides multi-year food aid commitments and loan forgiveness as incentives to low-income countries to undertake development-oriented economic policy reforms.

If AID decides to require policy reform in exchange for the use of its assistance, it can use a number of mechanisms. For example, informal, written agreements can form the basis of conditionality, or an exchange of letters between governments can outline the agreed-on policy actions. Or because of their sensitive nature, conditions may not appear in written agreements.

Two types of policy-related conditions which are included in the bilateral agreements or in AID's program documents are conditions precedent or covenants.¹ A condition precedent is an action AID requires the recipient government to take before assistance funds can be disbursed. A covenant is an action AID requires the recipient government to take before, during, or after assistance is provided, but is not required for disbursement. Covenants could involve actions that continue over a period of time, such as maintaining free market prices. Conditions precedent and covenants are found in both ESF and DA agreements. Self-help measures, which are unique to the P.L. 480 program, are similar to covenants; they are actions the recipient government agrees to undertake, but are not required prior to the delivery of food commodities. AID policy guidance suggests that conditions precedent, covenants, and self-help measures be as explicit as possible, though not necessarily quantifiable, to facilitate monitoring and evaluating progress.

This paper covers conditionality in AID project and program assistance in six countries. The DA projects studied generally do not contain extensive policy-related conditionality. Only 6 of the 19 DA projects studied required the recipient governments to take policy actions as conditions precedent or covenants. Three of these six projects are in Bangladesh where AID is a relatively large donor, and where policy dialogue is not affected by overriding U.S. security concerns. Since Bangladesh does not receive ESF assistance, DA and P.L. 480 are the primary vehicles for policy reform. Of the three other projects containing conditionality--one in Honduras and two in Sudan--two focus on sectoral policy and the third focuses on trade policy. Also, in the countries in which AID did not use conditionality extensively in project assistance--Costa Rica, Honduras, Sudan--AID has significant ESF programs in which conditionality is an integral part.

Of the eight ESF projects studied, the four with policy-related conditionality were all in Egypt. In most cases, ESF projects finance activities within AID's six development accounts and usually have the sectoral policy orientation of DA funded projects. In Egypt, AID has attached some conditionality to its ESF project assistance focusing on Egypt's need for major economic adjustments. However, the political nature of the Egypt program limits the extent of the conditionality which AID can apply.

¹The summary of Costa Rica includes discussion of several conditions known as "Prior Actions" which were not part of formal agreements, but which were identified by AID as significant policy conditions.

AID's conditionality in ESF program assistance has focused primarily on macroeconomic reform. Generally, the extent and success of AID's conditionality varied in each program reviewed. For example, U.S. political and security interests in Honduras and the Government of Honduras' reluctance to undertake reforms has affected AID's ability to enforce and require difficult policy changes. In Egypt, where U.S. political interests are also an important factor, AID has not required the Government of Egypt to undertake extensive policy reform, although policy dialogue is a part of AID's program. In Costa Rica, on the other hand, AID has been more successful because of effective donor coordination and the Government of Costa Rica's commitment to economic adjustment.

P.L. 480 programs, as required by legislation, contain self-help measures aimed at improving the efficiency of the agriculture sector. The policy focus of the self-help measures differed in each country. For example, AID's emphasis on economic policy reform in Bangladesh is evident in the P.L. 480 Title III program.

OBJECTIVES, SCOPE,
AND METHODOLOGY

All information for this study was obtained from AID and no independent verification of this information was made. Six countries were studied--Bangladesh, Costa Rica, Egypt, Honduras, the Philippines, and Sudan--because of (1) their geographic diversity; (2) their AID program diversity, i.e., most have DA, ESF, and P.L. 480 programs; and (3) the size of their AID programs. These countries represent 13 percent of estimated 1984 DA funds, 37 percent of ESF funds and 45 percent of P.L. 480 Titles I and III assistance. Table I shows AID assistance to the review countries for 1982-84.

Table 1
AID Programmed Assistance for Fiscal Years 1982-1984

<u>Country</u>	<u>Fiscal year</u>	<u>Type of assistance</u>		
		<u>DA</u>	<u>ESF</u>	<u>P.L. 480 Titles I (III)</u>
-----(\$ millions)-----				
Egypt	1982	0	771	285 (15)
	1983	0	750	225 (15)
	1984	0	853	250 (0)
Sudan	1982	24	100	5 (20)
	1983	29	82	30 (20)
	1984	21	120	30 (20)
Costa Rica	1982	12	20	18 (0)
	1983	27	157	28 (0)
	1984	15	130	20 (0)
Honduras	1982	31	35	2 (5)
	1983	31	56	5 (5)
	1984	31	113a	15 (0)
Philippines	1982	39	50	0
	1983	37	50	0
	1984	32	50	0
Bangladesh	1982	74	0	0 (64)
	1983	79	0	0 (60)
	1984	77	0	0 (68)

Source: 1985 and 1986 Congressional Presentations and other sources.

a\$72.5 million has not been disbursed.

For each country (except the Philippines),² all ESF program agreements (e.g., commodity import program, cash transfers), and P.L. 480 Titles I and III agreements, for the requested 1982-85 time period were studied. Up to 6 projects begun during 1982 to 1984 in each country were randomly selected--27 in all. Information on 1985 projects and programs was included whenever possible. However, nearly all 1985 activities are still in the proposal stage.

²Specific projects and agreements in the Philippines were not studied because AID's program for the years 1982-84 did not contain conditionality.

For each of these projects and programs the conditions required by AID of the host government were examined. These include conditions precedent, covenants and self-help measures. Only those conditions which were considered to be related to policy reform were included. The various administrative conditions were excluded. For example, AID agreements typically include conditions related to procurement matters, the need for periodic evaluations or audits, maintenance of an adequate host-government staff to implement the project or program and legal details such as requirements for specimen signatures of key host-government officials. Administrative conditions may involve changes in recipient government operations and can be more significant than a policy change. For example, a condition requiring establishment of a centralized procurement system could involve a change to the government's constitution. Making these distinctions on administrative versus policy conditions involved some subjective judgement. However, in studying project and program assistance, the nature of the conditions was discussed with AID officials to identify those which were policy related.

The policy-related conditions that were examined are those found in the legal agreements. Conditions that AID may have wanted to make, but excluded, for whatever reason, from the final agreement were not studied, nor were specific aspects of whatever policy dialogue AID may have underway with the host government. Furthermore, local currency transactions funded through commodity import grants or cash transfer grants were not studied. Although these transactions may involve policy reform, the decentralized nature of their management would make difficult a study that was limited to Washington.

The status of the conditions was determined when possible by examining AID records. However, for many of the conditions, the status was obtained through discussion with AID officials in Washington. Because of the time constraints, it was not possible to verify the accuracy of the information obtained through interviews or assess the quality of the actions reportedly taken to meet the conditions or covenants.

Macroeconomic and microeconomic is defined as follows for the purposes of this document. Macroeconomic policies relate to the economy as a whole, e.g., aggregate production, employment, taxation and public spending, interest rate, foreign trade, and exchange rate policies. Microeconomic policies relate to specific sectors, e.g., education criteria, health standards, agricultural pricing, and marketing.

SUMMARY TABLES

The following tables summarize what was found. Basic information about each project and program is given as well as,

if applicable, the nature of the policy conditionality (macro stands for macroeconomic and micro stands for microeconomic, both defined above), a summary of the conditionality and a general statement about whether the conditionality was met from AID's point of view. The reader is referred to a page in the text for further information. "Type of Assistance" refers to the funding source. The funding account for each DA project is given as follows: A/RD/N, Agriculture, Rural Development and Nutrition; PP, Population Planning; HE, Health; EHR, Education and Human Resources; and SDA, Special Development Activities.

Project/Program	Type of assistance	Fiscal year initiated	Amount (\$ millions)	Costa Rica		Type of conditionality ^a	Were conditions met? ^b	See the following pages for details
				Policy conditionality	Nature of conditionality			
Campesino Union Strengthening (515-0180)	A/RD/N	1982	0.5 grant	No	-	-	-	17
Private Sector Export Credit (515-0187)	A/RD/N	1982	10 loan	No	-	-	-	17
Northern Infrastructure Development (515-0191)	A/RD/N	1982	14.7 loan and grant	No	-	-	-	17
Training for Private Sector Development (515-0212)	EHR	1984	5 grant	No	-	-	-	18
Health Service Support (515-0203)	HE	1983	10.3 loan and grant	No	-	-	-	18
Family Planning Self-Reliance (515-0168)	PP	1983	2.5 grant	No	-	-	-	18
∞ Economic Stabilization Recovery I (515-0185)	ESF	1982	20 loan and grant	Yes	Macro	Negotiate with IMF; banking/currency legislation; export development	Yes	20
Economic Stabilization Recovery II (515-0186)	ESF	1983	64.5 loan and grant	Yes	Macro	Exchange rate adjustment; private sector development; IMF stand-by; credit policy; banking/currency legislation	Yes	22
First Amendment	ESF	1983	9.2 loan and grant					24
Second Amendment	ESF	1983	5 grant					25
Third Amendment	ESF	1983	45 loan and grant	Yes	Macro	Credit policy; export policy	Partially ^c	25

^aThis is not an exhaustive listing of conditions. For a full listing, refer to the specific country section.
^bDeterminations about compliance are based on examination of AID documents and discussions with AID officials.
^c"Partially" indicates that the recipient government has complied with some of the conditions in the agreement.

Costa Rica (continued)

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality^a</u>	<u>Were conditions met?^b</u>	<u>See the following pages for details</u>
Fourth Amendment	ESF	1983	32 loan and grant	Yes	Macro	Negotiate IMF stand-by; commercial bank credit	Partially	25
Economic Stabilization Recovery (Loan) III (515-0192)	ESF	1984	12 loan	Yes	Macro	Banking/currency legislation; Import/export management; IMF compliance	Partially	26
First Amendment	ESF	1984	23 loan	Yes	Macro	Compliance with previous conditions	Partially	30
Economic Stabilization Recovery (Grant) III (515-0192)	ESF	1984	35 grant	Yes	Macro	Banking/currency legislation; economic policy strategy	Partially	30
First Amendment	ESF	1984	60	Yes	Macro	Maintain compliance with previous conditions	Partially	33
P.L. 480	Title I	1982-85	94	Yes	Micro/Macro	Grain storage and handling; research extension; agricultural policy; export promotion	Partially	33

Honduras

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality</u>	<u>Were conditions met?</u>	<u>See the following pages for details</u>
Export Development and Services (522-0207)	SDA, A/RD/N	1984	22 loan and grant	Yes	Macro	Import/export legislation; establish export fund	Partially	40
Development Administration (522-0174)	EHR	1982	2.5 grant	No	-	-	-	40
Small Farmer Training Services (522-0173)	A/RD/N	1982	12 loan and grant	No	-	-	-	41
Tegucigalpa Power Restoration (522-0026)	ESF	1982	1.8 grant	No	-	-	-	41
Small Farmer Livestock (522-0209)	A/RD/N	1983	12 loan and grant	No	-	-	-	41
Small Business Development (522-0205)	SDA	1984	0.6 grant	No	-	-	-	42
Economic Recovery Program (522-0192)	ESF	1982	35 loan	Yes	Macro	IMF stand-by	Yes	43
First Amendment	ESF	1983	3 loan	Yes	Macro	IMF stand-by	Yes	44
Second Amendment	ESF	1983	15 loan and grant	Yes	Macro	IMF stand-by; tax policy; debt renegotiation	Yes	45
Third Amendment	ESF	1983	8 loan and grant (not disbursed due to non-compliance)	Yes	Macro	IMF stand-by; tax policy; policy studies; export policy	Waived	45
Fourth Amendment	ESF	1983	30 loan and grant (not disbursed due to non-compliance)	Yes	Macro	IMF stand-by; policy studies; export policy	Partially	46

Honduras (continued)

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality^a</u>	<u>Were conditions met?^b</u>	<u>See the following pages for details</u>
Fifth Amendment	ESF	1984	0 (alter conditions to Third Amendment)	Yes	Macro	Tax policy; economic policy discussions	Yes	47
Sixth Amendment	ESF	1984	0 (alter conditions to Fourth Amendment)	Yes	Micro/Macro	Tax policy; economic policy discussions	Partially	49
Seventh Amendment	ESF	1984	30 loan and grant	Yes	Macro	External debt payments	Partially	50
Eighth Amendment	ESF	1984	10 loan and grant (not disbursed)	Yes	Macro	Export/Import legislation and regulations; external debt payments	-	51
P.L. 480	Title I	1984	22	Yes	Micro	Agriculture policy changes; investment promotion; forestry reforms	Partially	52
P.L. 480	Title III	1982-83	10	Yes	Micro	Agriculture policy changes; water resource reform; farmer training	Partially	53

<u>Egypt</u>								
<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality</u>	<u>Were conditions met?</u>	<u>See the following pages for details</u>
Aswan High Dam Rehabilitation (263-0160)	ESF	1982	100 grant	Yes	Micro	Electricity pricing	No	55
Energy Policy and Renewable Energy Field Testing (263-0123)	ESF	1982	32.6 grant	No	-	-	-	56
Safaga Grain Silos (263-0165)	ESF	1982	80 grant	No	-	-	-	56
Family Planning II (263-0144)	ESF	1983	102.6 grant	Yes	Micro	Acceptance of family planning	No	57
Ismailia Thermal Power Plant (263-0009)	ESF	1983	109 grant	Yes	Micro	Electricity pricing	No	57
Cairo Sewerage II (263-0173)	ESF	1984	See p. 58	Yes	Micro	Water/Waste-water pricing	Yes	58
1982 Commodity Import Program (263-K-604)	ESF	1982	350 grant	Yes	Macro	Economic policy dialogue	Yes	59
1983 Commodity Import Program (263-K-606)	ESF	1983	301.1 grant	Yes	Macro	Economic policy dialogue	Yes	59
1984 Commodity Import Program (263-K-607)	ESF	1984	300 grant	Yes	Macro	Economic policy dialogue	Yes	60
1984 Program Cash Transfer (263-K-608)	ESF	1984	101.9 grant	No	-	-	-	60
P.L. 480	Title I	1982-84	760	Yes	Micro	Agricultural policies	Partially	61
P.L. 480	Title III	1982-83	30	Yes	Micro	Agricultural policies	Partially	61

Bangladesh

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality</u>	<u>Were conditions met?</u>	<u>See the following pages for details</u>
Rural Finance (388-0057)	A/RD/N	1983	75 grant	Yes	Micro	Rural savings; Interest rate policy	Yes	65
Fertilizer Distribution Improvement II (388-0060)	A/RD/N	1984	65 grant	Yes	Micro	Marketing policy, private sector participation	No	68
Family Planning Services (388-0050)	PP	1984	26 grant	Yes	Micro	Voluntary sterilization program monitoring	Yes	69
P.L. 480	Title III	1982-85	284	Yes	Micro	Agricultural policies	Yes	70

Sudan

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality</u>	<u>Were conditions met?</u>	<u>See the following pages for details</u>
Southern Agricultural Development I (650-0046)	A/RD/N	1982	10.1 grant	No	-	-	-	74
Energy Planning and Management (650-0059)	SDA	1982	8.5 grant	Yes	Micro	Donor coordination, pricing and private sector participation in the energy sector	Partially	75
Model Family Planning (650-0063)	PP	1982	1.8 grant	No	-	-	-	76
Southern Region Road Maintenance and Rehabilitation (650-0043)	A/RD/N	1983	19.7 grant	No	-	-	-	76
Policy Analysis and Implementation (650-0071)	ESF	1983	5 grant	No	-	-	-	77
Western Sudan Agricultural Marketing Road (650-0069)	A/RD/N	1984	60 grant	Yes	Micro	Transportation sector regulations and donor coordination	See p. 77	77
1982 Commodity Import Program (650-K-603)	ESF	1982	100 grant	Yes	Macro	Economic policy changes including private sector participation, exchange rates, imports, price controls, etc.	Partially	78
1983 Commodity Import Program (650-K-604)	ESF	1983	60.25 grant					80
1983 Program Grant (650-K-605)	ESF	1983	20 grant					82
1984 Commodity Import Program (650-K-606)	ESF	1984	102 grant (82.5 not disbursed)					83
1984 Program Grant (650-K-607)	ESF	1984	18 grant	Yes	Macro	Economic reform involving budgetary reductions, taxation, and decentralization.	Yes	84

Sudan (continued)

<u>Project/Program</u>	<u>Type of assistance</u>	<u>Fiscal year initiated</u>	<u>Amount (\$ millions)</u>	<u>Policy conditionality</u>	<u>Nature of conditionality</u>	<u>Type of conditionality</u>	<u>Were conditions met?</u>	<u>See the following pages for details</u>
P.L. 480	Title I	1982-85	115	Yes	Micro	Agricultural policies	Partially	85, 90
P.L. 480	Title III	1982-84	60	Yes	Micro	Agricultural policies	Partially	88

II COSTA RICA

AID's overall strategy in Costa Rica is to help the Government of Costa Rica (GOCR) recover from a serious economic downturn which occurred in the early 1980s. According to AID's Congressional Presentation, AID's strategy in Costa Rica is to "...assist the Government of Costa Rica (GOCR) in consolidating its stabilization program, implementing the policy reforms needed to achieve rapid and sustained economic recovery, preserving the country's commendable attainments in meeting equity objectives, and forestalling challenges to Costa Rica's long established democratic traditions." The elements of AID's assistance programs--P.L. 480, Development Assistance, and the Economic Support Fund program--support this strategy and complement one another.

AID uses conditionality most frequently in the ESF program, and believes its conditionality has been successful. According to AID officials, several important policy actions have been taken, and Costa Rica has shown a strong commitment to policy reform.

AID has reported progress on many of the self-help measures in the Public Law 480 program, which are directly tied to AID's country strategy. For example, self-help measures to evaluate and adjust pricing policies support the ESF program objective of increased private-sector growth. The self-help measure to eliminate subsidies to Costa Rica's National Production Council supports AID's overall effort to encourage self-sustaining public sector enterprises.

AID's DA projects rely less on policy conditionality than do the ESF and Public Law 480 programs, and instead, support Costa Rica's long-term development needs. AID development projects are taking advantage of the improved policy environment created in part by AID's policy dialogue.

PROJECT ASSISTANCE

We reviewed six projects active during fiscal years 1982-84. Although the conditions precedent for disbursement for these projects did not require the GOCR to undertake policy actions, we found that the conditions precedent often required the implementing institutions to take actions AID considered necessary for effective implementation and project success. An AID official explained that the AID mission and Latin America bureau examine the implementing institutions critically and, through the use of conditions precedent, try to head off possible problems. For example, in the Private Sector Export Credit project, AID incorporated a number of conditions to disbursement intended to strengthen the private-sector financial

institution providing the credit under the project. In the Family Planning Self-Reliance project, several of the conditions precedent and covenants establish controls on the activities of the private organization responsible for the retail sales component; one condition to disbursement requires the organization to provide legally binding documentation to AID that it will reinvest project-related profits into project activities.

A summary of the six projects and their status follows:

1. Campesino Union Strengthening (515-0180)

--Agreement dated 1982

--\$500,000 grant (life-of-project funding authorized at \$600,000)

--Agriculture, Rural Development, and Nutrition Account

--This project is supporting and strengthening the trade union movement in Costa Rica by financing training seminars and conferences for labor leaders and union members and providing labor activists to promote affiliation to the trade unions.

There was no policy-related conditionality.

2. Private Sector Export Credit (515-0187)

--Agreement dated Sept. 1982

--\$10 million loan (life-of-project funding authorized at \$10 million)

--Agriculture, Rural Development, and Nutrition Account

--This project is providing credit for export development and is intended to strengthen a private-sector development-oriented financial institution.

There is no policy-related conditionality.

3. Northern Infrastructure Development (515-0191)

--Agreement dated July 1982

--\$14.2 million loan, \$.5 million grant (life-of-project funding authorized at \$14.7 million)

--Agriculture, Rural Development, and Nutrition Account

--This project will expand community level infrastructure and encourage community initiated development in Costa Rica's northern region.

There is no policy-related conditionality.

4. Training for Private Sector Development (515-0212)

--Agreement dated Aug. 1984

--\$5 million grant (life-of-project funding authorized at \$5 million)

--Education and Human Resources Account

--This project finances training in the United States and Costa Rica to strengthen the human resources needed for private sector development.

There is no policy-related conditionality.

5. Health Services Support (515-0203)

--Agreement dated Aug. 1983

--\$10 million loan; \$0.3 million grant (life-of-project funding authorized at \$10.3 million)

--Health Account

--This project provides pharmaceuticals and other medical supplies to Costa Rica's health-care system.

There is no policy-related conditionality.

6. Family Planning Self-Reliance (515-0168)

--Agreement dated July 1983

--\$2.5 million grant (life-of-project funding authorized at \$2.5 million)

--Population Planning Account

--This project will expand and strengthen family planning services provided by the public and private sectors.

This project has no policy-related conditionality.

ECONOMIC SUPPORT FUND
PROGRAM ASSISTANCE

Costa Rica's stability is of great importance to the United States because of its unique history of strong democratic government in a politically volatile region. In 1982, when Costa Rica faced possible economic collapse because of heavy external borrowing, AID began providing direct ESF assistance for immediate balance-of-payments support. However, when the United States decided to provide this badly needed assistance, it also decided that more than a "bail out" was needed; AID adopted a long-term strategy to provide assistance in coordination with encouraging the GOCR to make necessary economic policy adjustments.

In this context, the ESF program has been successful, according to AID officials. AID officials told us that AID's policy dialogue, coordinated with other donors, particularly the World Bank and the International Monetary Fund, has moved Costa Rica toward making some very politically difficult economic reforms. They identified several key policy reforms taken by the GOCR since the start of AID's ESF program:

- The exchange rate has been adjusted to reflect market value.
- Economic policies have been reoriented to remove disincentives to private sector development.
- Obstacles to increased export production have been removed.
- Progress has been made on negotiating a renewed stand-by arrangement with the IMF.

The covenants and conditions precedent in AID's ESF agreements have supported these broad accomplishments. For example, a covenant in the 1982 agreement successfully required the GOCR to submit to the General Assembly, modifications to Costa Rica's banking/currency law to permit private banks to make dollar dominated loans and have access to the Central Bank funds. These changes are intended to create needed competition between private and public banks and eliminate loopholes in the laws which threatened the solvency of Costa Rica's private financial institutions. AID, in coordination with the World Bank, encouraged approval of these modifications by the General Assembly through conditionality in subsequent ESF agreements.

AID's policy dialogue has also emphasized the importance of an IMF agreement to Costa Rica's economic recovery. In 1982 and 1983, AID required the GOCR to remain in compliance with the IMF

stand-by arrangement negotiated in December 1982. When the GOCR fell out of compliance in December 1983, AID conditioned future assistance on negotiating a new arrangement. However, the AID mission's ESF status report stated that AID cannot condition 1984 supplemental or 1985 assistance on IMF requirements because of the Kemp-Kasten Amendment. The GOCR is expected to sign a stand-by arrangement in March 1985.

Since 1982, Costa Rica has received \$305.7 million in ESF loans and grants, in the form of direct cash transfers. The following table shows assistance levels by fiscal year and loan/grant breakdowns.

<u>Fiscal year</u>	<u>Loans</u>	<u>Grants</u>	<u>Total ESF assistance provided</u>
	------(millions)-----		
1982	\$ 15	\$ 5.0	\$ 20.0
1983	118	37.7	155.7
1984	<u>35</u>	<u>95.0</u>	<u>130.0</u>
	<u>\$168</u>	<u>\$137.7</u>	<u>\$305.7</u>

Assistance in 1982 was provided under a combined loan and grant agreement. In 1983, assistance was provided through a combined loan and grant agreement and a series of amendments which increased the funding levels and in some cases amended covenants in the original agreement or added new covenants. In 1984, assistance was provided through separate loan and grant agreements, each of which was amended to increase the funding levels and require new policy actions.

The following is a summary of the covenants and conditions required under each of AID's ESF agreements and their status. All information on status was provided by AID officials at the mission and in Washington.

1. Economic Stabilization and Recovery, FY 1982 (515-0185)

--Agreement dated July 14, 1982

--\$15 million loan; \$5 million grant

--Economic Support Fund; cash transfer

The AID mission provided specific information on the status of the covenants in the 1983 and 1984 ESF agreements in a January 1985 Status Report. The mission did not report on the status of the covenants in the 1982 Agreement because the GOCR had fully complied with all the covenants at the time of the status report. Information on the status of this agreement was obtained from AID officials in Washington. Below are the actions which were required under the 1982 agreement.

Covenant: Seek legislative changes to the banking/currency law to allow private commercial banks access to Central Bank resources.

Status: Met. The covenant required the GOCR to submit the proposed legislation to the General Assembly. The amendment was submitted to the General Assembly, thus meeting the terms of this covenant. The proposed changes encountered major opposition in the General Assembly; policy dialogue between AID and the GOCR continued into 1984, when the amendment was passed by the General Assembly.

Covenant: Agree to negotiate with the IMF and to implement a stabilization program.

Status: Met. Costa Rica agreed to an Extended Fund Facility with the IMF which was to run from June 1981 through June 1984. In early 1982, however, Costa Rica fell out of compliance. AID then required that the GOCR negotiate a stand-by arrangement as a covenant to this agreement, which it did in December 1982. One year later, Costa Rica fell out of compliance with the stand-by arrangement by implementing certain tax policies which were disincentives to exporters. At that time, according to AID officials, AID withheld disbursements of ESF assistance for approximately 25 days until the GOCR removed the disincentives.

Covenant: Adopt and maintain a system giving exporters preferential access to export earnings to procure goods for continued export production.

Status: Met. The required system was implemented by the Central Bank.

Covenant: Increase allocation of foreign exchange resources to the private sector through the National Banking System by \$20 million.

Status: Met. The mission reported that the GOCR has made periodic reports on public and private sector foreign

exchange sales, through August 1984. These reports show full compliance with the covenant.

Covenant: Allocate to the private sector, the foreign exchange equivalent of the cash transfer, for imports of raw material, intermediate goods and spare parts from the United States.

Status: Met. The mission stated that while the Central Bank's compliance reports did not differentiate between public and private sector importers of U.S. goods, major public sector importers do not import from the United States due to tied credits, thus U.S. exports were handled by the private sector.

Covenant: Permit use of local currency generated by the sale of U.S. dollars (under this cash transfer) for programs jointly agreed to by AID and the GOCR.

Status: Met.

Covenant: Under the national credit plan, increase the credit ceiling for the industrial sector in 1982 by the local currency equivalent of \$15 million.

Status: Met. The mission reported that the GOCR fully complied with the required credit levels.

2. Economic Stabilization and Recovery II, FY 1983 (515-0186)

The original assistance agreement for fiscal year 1983 was signed December 13, 1982. During 1983, subsequent amendatory assistance agreements were signed which increased funding levels and added and amended conditions and covenants. Total funding in fiscal year 1983 was \$155.7 million.

Original Assistance Agreement

--Agreement dated Dec. 12, 1982

--\$56.5 loan; \$8 million grant; cash transfer

Condition Precedent: Final agreement with the IMF.

Status: Met. The GOCR entered into an IMF stand-by arrangement in December 1982.

Condition Precedent: Submit to the General Assembly an amendment to the banking/currency law.

Status: Met. This covenant only required that the proposed amendment be submitted. In subsequent ESF agreements, AID required passage of the amendment and approval of implementing regulations.

Covenant: Provide the Costa Rican Coalition of Development Initiatives with local currencies generated by the \$8 million of this cash transfer.

Status: Met.

Covenant: Allocate the foreign exchange equivalent of the cash transfer for imports from the United States, within 3 months of the cash transfer.

Status: Met.

Covenant: Move toward unification of the exchange rate by December 31, 1983.

Status: Met. The Central Bank has maintained a unified exchange rate since November 1983. The Central Bank's reports on maintaining the colon at a competitive level with Costa Rica's trading partners have been regularly provided to AID and the IMF. As a result of Central Bank analyses, the Central Bank periodically devalued the colon in 1984 from 43.5 colones to one dollar to 47.5 colones to one dollar. A further devaluation to 47.94 to one was enacted in January 1985. Additional periodic devaluations are expected in 1985.

Covenant: Maintain the system giving exporters preferential access to export earnings to procure goods for continued export production.

Status: The mission reported that when the exchange rate was unified, this covenant became irrelevant, although, the "spirit of the covenant" was maintained because the Central Bank maintained a list of exporters to receive expedited access to foreign exchange. However, when foreign exchange became scarce in late 1984, the list was suspended and all purchasers were required to wait about 50 days for foreign exchange. As a result of continuing policy dialogue with AID, the Central Bank has agreed to reinstate the list when the supply of foreign exchange increases. The AID mission stated that it will continue to monitor the situation and "press for suitable action at the appropriate moment."

Covenant: Provide AID with all reports submitted to the IMF concerning compliance with stabilization programs.

Status: Met. The mission reported that it receives monthly and weekly copies of Central Bank reports to the IMF.

Covenant: Establish a special credit line with \$10 million of local currency (from the U.S. cash transfer) for use exclusively by private banks as credit to private producers.

Status: Met.

Covenant: Establish a credit line with \$5 million of local currency (generated by this cash transfer) for mortgage financing for families below the median income level.

Status: Met.

Covenant: Under the national credit plan, increase by the local currency equivalent of \$41.5 million, the resources for unsubsidized lending through commercial banks to the private sector for industry and agriculture.

Status: Met. The required credit level was established.

Covenant: Establish reporting procedures to verify that small industry qualifies for local currency resources and allocate the equivalent of \$3 million for subsidized credit to this group.

Status: Met. The mission reported that new regulations channeling local currency resources to small industry are in full operation. The local currency has been committed to this credit line, but not disbursed. The mission added that the Central Bank is considering moving the interest rate up to positive terms and maintaining the subsidized rate only for artisan credit.

Covenant: Assistance provided under this agreement will not cause injury to U.S. agricultural enterprises.

Status: Mission reported that "no evidence of non-compliance exists."

First Amendatory Assistance Agreement

--Agreement dated March 28, 1983

--\$5.985 million loan; \$3.25 million grant

This amendment did not change the covenants or conditions of the original agreement except to increase the foreign and local currency allocations. The required allocations were met.

Second Amendatory Assistance Agreement

--Agreement dated May 31, 1983

--\$5 million grant

The substantive covenants under the original agreement were not changed; however, there was a requirement on allocation of the increased foreign exchange and local currency. The mission reported that the required increases were made.

Third Amendatory Assistance Agreement

--Agreement dated Aug. 29, 1983

--\$30.5 million loan; \$14.485 million grant

This agreement required the Central Bank to allocate foreign exchange to importers and deposit the local currency generated by the sale of the foreign exchange in a special account. The agreement also added several covenants which increased local currency resources in various credit lines established under earlier agreements; the covenants were met.

Two important new covenants were added:

Covenant: Establish a \$10 million credit guarantee program which guarantees loans for industry, agriculture, export activities, and related services.

Status: Not met. The Mission reported that the Central Bank is legally prohibited from using the funds in question for this purpose, but the mission and Central Bank are currently discussing alternatives.

Covenant: Maintain a policy which does not weaken Costa Rican exports in foreign markets.

Status: AID reported that Costa Rica's periodic exchange rate adjustments have helped keep exports competitive.

Fourth Amendatory Assistance Agreement

--Agreement dated Sept. 30, 1983

--\$25 million loan, \$7 million grant; cash transfer

Three covenants were added under this amendment. Two required the GOCR to increase resources in the special credit line for private commercial banks and to maintain the credit level

programmed in the 1983 National Credit Program to ensure that commercial banks have sufficient liquidity. These covenants were met.

A third covenant concerned negotiating a new IMF arrangement.

Covenant: Negotiate and implement a 1984 IMF stand-by arrangement.

Status: The mission reported that the GOCR has been negotiating with the IMF since mid-1984. A letter of intent, which outlines the actions the GOCR is willing to take, has been signed by the GOCR, accepted by IMF management, and is awaiting approval of the IMF Board of Directors. The AID mission expects approval in early March. The mission added, however, that the question of compliance with this covenant is "moot" since, under the terms of the Kemp-Kasten Amendment, AID can no longer condition assistance on compliance with IMF programs or requirements.

3. Economic Stabilization and Recovery (Loan) III, FY 1984
(515-0192)

--Agreement dated May 7, 1984

--\$12 million loan, amended July 12, 1984 for an additional \$23 million for a total of \$35 million

This agreement contained two "prior actions." AID requires a recipient government to take "prior actions" before an agreement can be signed. One "prior action" was met. The second, which required modifications to Costa Rica's banking/currency law, was waived by AID.

Prior Action: Approval of an amendment to the banking/currency law

Status: Waived. According to AID, the GOCR took some action when private banks were permitted access to foreign credit. AID believed this was an important step but also maintained that the additional steps of permitting direct access to all credit, and permitting the banks to make dollar-dominated loans were also crucial. Although the GOCR did not take the required action, AID decided to disburse \$12 million of the loan funds because of the GOCR's immediate need for balance-of-payments support and the President of Costa Rica's commitment to continue to press the General Assembly for full passage of the amendment. The remaining \$23 million was disbursed under the amendment to the loan agreement after the amendment was passed in August 1984.

Prior Action: Submission of a GOCR Letter of Intent, with acceptance by the IMF management.

Status: Met. The Letter of Intent was accepted in April 1984.

The following are the covenants in the loan agreement.

Covenant: Take a number of actions to correct credit and interest rate policy, including;

--Reduce the number of credit ceilings.

Status: Met. According to AID, as a result of AID policy dialogue, the Central Bank has progressively reduced credit ceilings and moved further away from non-price credit allocations.

--Develop a credit program for the Costa Rica Development Corporation (CODESA) limited to operational credit requirements.

Status: Met. The mission reported that the Central Bank provided no new cash to CODESA in 1984. AID and the GOCR are attempting to make CODESA a self-financing development organization.

--The Central Bank will not provide credit to the National Production Council (NPC), an agricultural marketing board, to cover the Council's costs of selling subsidized commodities.

Status: Met. The Central Bank reported that it is in compliance with this covenant; AID states that it will make a formal determination on compliance when year-end figures become available.

--The basic real interest rate will continue to be positive in 1984. The basic real interest rate is the difference between the basic passive rate and the inflation rate. Maintaining a positive rate provides an incentive for domestic savings and encourages more productive investment.

Status: Met. The mission reported that the Central Bank held the basic passive rate at 18 percent during most of 1984 and recently increased it to 20 percent. The domestic inflation rate for this period has been between 15 to 16 percent.

--Interest rates on all agricultural activities, except livestock breeding, which can have a lower rate, will be increased from the basic passive rate.

Status: Met. Agricultural activities, except livestock breeding, are now charged 21.5 percent. Livestock breeding activities get credit at the basic passive rate.

--The Central Bank will offer no more than two positive interest rates for non-agricultural purposes.

Status: Met. Productive credit is provided at 23.5 percent and commercial credit is provided at 28 percent, as of February 1985.

--The National Banking System will provide subsidized credit (credit below the basic passive rate) only as specified in the National Credit Program and total subsidized lending is not to exceed 16 percent of total lending.

Status: Met. This covenant set limits on the types, amount, and source of financing for subsidized credit during CY 1984. Although final data are not yet available, data through CY 1984 shows that state banks have placed 16 percent of total credit in subsidized loans. The 1985 credit program announced by the Central Bank will limit subsidized credit to 15 percent of total lending. The restrictions on activities to receive subsidized credit have been followed.

--The Central Bank will finance at least 50 percent of the subsidized loans under the above covenant.

Status: Met. The Central Bank has financed 50 percent of the subsidized loans, thus complying with the covenant, according to the mission.

--Active and passive rates will be revised as necessary to reflect market levels.

Status: The mission did not report on the status of active rates; however, the GOCR has made the necessary revisions to the passive rate.

--Design a program to reduce the cost of providing credit based on the recommendations of the National Banking System Commission Report.

Status: Not met. The mission reported that the Commission's recently completed report is not a suitable basis for developing an action plan. The mission states it is awaiting the reactions of the Costa Rica Bankers' association before attempting to develop such a plan.

Covenant: Maintain a unified exchange rate and review the rate on a continuing basis.

Status: Met.

Covenant: Improve the quality, timeliness and use of economic information.

Status: Met. A master plan for improving Central Bank management information systems was completed in August 1984. The Central Bank is reviewing proposals for technical assistance for implementation of the plan which is expected to begin in early 1985 and run for 3 years.

Covenant: Prepare a plan of action by June 1984, to monitor import and export transactions to control over- and under-invoicing.

Status: Met. The plan was provided about 3 months after the June 1984 deadline. The Central Bank first contracted with a U.S. firm which was unable to develop an appropriate plan. Central Bank officials then reviewed El Salvador's and Columbia's procedures. The draft plan, which was submitted in November 1984, would create a new department to monitor transactions. The mission and the Central Bank are in the process of discussing proposed modifications. According to the mission, the plan will be implemented in the first quarter of 1985.

Covenant: The Central Bank will support the creation of a secondary mortgage bank to address the lack of mortgage financing which has depressed housing production below the country's needs.

Status: Pending. AID and the Ministry of Housing sponsored a visit by a housing specialist to discuss this problem which resulted in renewing several stalled GOCR initiatives. A technical committee within the housing ministry was formed to develop legislation for a mortgage bank. According to the mission, AID will continue to discuss with Central Bank and other GOCR officials how this objective can be met. The mission believes that because the covenant does not require the Central Bank to initiate any action but instead to lend support, compliance at this time is not "relevant."

Covenant: Make available to the private sector, foreign exchange (equivalent to the cash transfer) for imports of raw materials, and other productive goods from the United States.

Status: Met.

Covenant: Prepare a report on the implementation of the National Credit Program for 1982 and 1983, by June 30, 1984.

Status: Met.

Covenant: Provide copies to AID of all reports made to the IMF, and any documents pertaining to the covenants under this agreement.

Status: Met.

First Amendment to the Loan Agreement

--Agreement dated July 12, 1984

--\$23 million grant; cash transfer

The amendment added one covenant and a special provision.

Covenant: Allocate local currency (equivalent to \$20 million) to support the Central Bank Credit Program's unsubsidized lending to the private sector for industry, agriculture, and construction.

Status: Met.

Special Provision: If AID determines the Central Bank is not in compliance with any AID covenant, AID may suspend disbursements until compliance has been attained.

4. Economic Stabilization and Recovery (Grant) III, FY 1984 (515-0192)

--Agreement dated Aug. 1, 1984

--\$35 million grant, amended Sept. 30, 1984 for an additional \$60 million; the total under the grant agreement is \$95 million; cash transfer

AID required two "prior actions" to the signing of the grant agreement.

Prior Action: Issuance of an economic policy strategy.

Status: Met. In May 1984, the President of Costa Rica issued "Economic Policy: Strategy Actions, 1984-1986" which describes the GOCR's export and investment policy strategy.

Prior Action: Passage of modifications to Costa Rica's banking/currency law.

Status: Waived. In late July 1984, when it was evident to AID that passage of the amendment was being delayed by debate in the General Assembly, AID decided to waive this "prior action" and disburse \$15 million of the grant funds. AID officials explained that the decision to waive this prior action was made because of the GOCR's commitment to pursue this issue, and because withholding disbursement would have resulted in immediate, serious balance-of-payments problems for Costa Rica. On August 19, 1984, the President of Costa Rica called a special session of the General Assembly for the express purpose of passing the proposed amendment; the amendment passed that day. The mission reported that modifications to the law, achieved as a result of AID policy dialogue, give private banks direct access to Central Bank resources.

The following are the covenants in the grant agreement.

Covenant: The Ministry of Public Works and Transport is to initiate a demonstration program to encourage the use of private sector contracting for road maintenance.

Status: Met. An agreement was signed between the Ministry and the Road and Highway Contractors Association in October 1984. The mission reported that having the Ministry use the private sector is a "milestone."

Covenant: The Municipal Development Institute will contract with private sector firms for water and sewage facility improvements.

Status: Compliance is expected in February 1985.

Covenant: Publish analytical studies to improve the functioning of maritime ports, stimulate increased exports of meat and sugar, and adjust pricing policies to stimulate increased production.

Status: Not met. The mission reported that the GOCR's deadlines for submitting proposals for these studies were originally too optimistic, but that more realistic targets have since been set. The mission received first drafts in October 1984 and made recommendations which the GOCR incorporated in the December 1984 draft. The mission expects the actual studies to be completed by late 1985. The covenant will not be met until the new government (elections are scheduled for February 1986) has developed action plans based on the studies and their recommendations, according to the mission.

Covenant: The Public Works Ministry will publish a decree to reduce port user tariffs.

Status: Not met. A decree was published, but according to the mission "it contains errors of commission and omission." The mission is working with the GOCR to correct the problems. Until the corrected decree is published and tariff reductions are made, no disbursements to the GOCR from the local currency special account will be made.

Covenant: Submit plans to AID for port improvements.

Status: Met. Plans were submitted and construction proposals are under review.

Covenant: Submit plans for the divestiture of the majority of the Costa Rican Development Corporation's holdings to the private sector.

Status: Not met. The mission reported that GOCR has not yet submitted a plan, although newspapers in Costa Rica have reported on the Corporation's proposals for divestiture. The mission has determined that it will not press the Corporation for compliance at this time because "alternative actions" are being considered.

Covenant: Publish new regulations to simplify the Free Zone Law and make it responsive to recent export and investment promotion policies.

Status: Not met. However, the mission expects publication of the new regulations during the first quarter of CY 1985. As background, the mission reported that a law giving new authority to the Free Zone Corporation (an autonomous public sector entity) was passed in January 1984. In October 1984, AID provided technical assistance to the Corporation in drafting the regulations.

Covenant: Establish and fund a special credit line for the private sector in the Central Bank to which private banks have access.

Status: Met. The mission reports that the credit line is in full operation and credit is flowing to the private sector. The Central Bank is providing AID with periodic reports on the status of disbursements from the fund.

Covenant: The Central Bank will submit to the General Assembly changes to the law governing the national savings and loan system authorizing the system to finance used housing, and household equipment. If a developer intends to offer completed units

for sale to members of savings and loan associations, the developer's construction and land-acquisition costs to build new housing will be financed. The objective of this covenant is to provide incentives to increased production of housing units.

Status: Not met. However, the mission reports that private sector parties, with GOCR support, have initiated efforts to modify the current law. According to the mission, the proposed changes if approved, will have a greater impact than those required under this covenant. AID and the Central Bank are monitoring the activities and working with savings and loans and GOCR officials on passage of the changes in the General Assembly.

Covenant: Deposit local currency generated by the ESF transfer into a special account.

Status: Met.

In addition to these covenants, this agreement contained a section regarding compliance with the IMF. AID reserved the right to suspend disbursements if the GOCR was not in substantial compliance with the IMF stand-by arrangement. Because the GOCR had not yet negotiated a stand-by, this covenant was deleted under the amendment to the agreement.

First Amendment to the Grant Agreement

--Agreement dated Sept. 30, 1984

--\$60 million, bringing the grant total to \$95 million;
cash transfer

This amendment did not change the covenants of the original grant agreement. However, it deleted the special section on IMF compliance and added a new section which stated:

--If AID determines the GOCR is not in substantial compliance with the covenants of the grant agreements, AID may suspend disbursements until satisfactory compliance has been attained.

PUBLIC LAW 480

The Costa Rican Government received P.L. 480 Title I food assistance in fiscal years 1982 through 1984 for a total of \$66 million. Approximately \$28 million is programmed for fiscal year 1985. The self-help measures in the agreements require the GOCR to adopt and maintain policies aimed at strengthening GOCR institutional capacity, increasing private sector participation in the economic and development process, and correcting inappropriate pricing policies.

The AID mission's progress reports noted that there have been "progress and problems" in the compliance with the self-help measures. Progress was seen in reorganizing agricultural research and extension services and strengthening private sector agricultural organizations. The mission stated that reducing the National Production Council's (NPC) deficit in 1982 and 1983 and setting NPC food prices at a competitive level were particularly significant accomplishments. These actions, according to the mission, reflect the GOCR's intention to reduce the public sector's deficit and stimulate increased domestic food production.

Delays surfaced in eliminating the NPC's debt in 1984, completing pricing studies, and providing agricultural credit. The mission noted that the problems are a result of normal bureaucratic delays, unrealistic time schedules for certain self-help measures, and unforeseen events in the agricultural sector. The mission also added that GOCR has exhibited a strong commitment to implementing the self-help measures.

We consolidated our review of the self-help measures in the 1982-1984 agreements because of their similarity. The self-help measures and their status are presented below.

Title I, FY 1982-84

(1) Pricing Policy

Self-help Measure: The GOCR is required to sell imported commodities financed by this Title I Program at prices which cover NPC's operational costs.

Status: NPC was in compliance with this self-help measure for fiscal years 1982-84.

Self-help Measure: The GOCR is to progressively reduce the deficit of the NPC and eliminate it by December 1983.

Status: The mission reported that NPC considerably reduced its operational deficit in 1982 and eliminated the deficit in 1983. NPC incurred a deficit in fiscal year 1984 due to a record rice crop production which the NPC purchased. AID and the GOCR have taken measures to avoid overproduction in the future.

Self-help Measure: The GOCR is to maintain the price for basic grains for domestic consumption at world price levels during 1983. The price of vegetable oil is to be set at the world level by December 1983.

Status: NPC basic grain prices are all above world market levels. No data was available on vegetable oil prices.

Self-help Measure: The Ministry of Planning was required to submit a study of methodologies currently applied for formulating producer and consumer food pricing policies by December 1984.

Status: Although the pricing policy study was submitted on time, it required modifications by the mission, which will delay its final completion until June 1985.

(2) Grain Storage and Handling

Self-help Measure: Starting in fiscal year 1982, the GOCR was to expand its storage and improve its grain handling and marketing systems.

Status: The deadline for complying with this measure was twice extended by AID. In January 1985 the GOCR requested an extension to June 1986. AID has expressed concern about bureaucratic delays and is reviewing the request. However, delays are also due in part to AID changes in the storage specifications.

Self-help Measure: The GOCR is to carry out an assessment of post harvest grain and handling and storage systems in 1985.

Status: The GOCR's proposal was found to be inadequate. AID and the GOCR are reviewing the study, which is now expected to be completed by August 1985.

(3) Research and Extension

Self-help Measure: The GOCR is to strengthen the agricultural technology delivery system by establishing private-sector producer associations in fiscal years 1982-84.

Status: In 1982, the GOCR agreed that two associations should be established, but did not take specific actions. In 1983, bills were submitted to the General Assembly, but no further action occurred. In 1984, funding was approved by the Assembly. AID expects movement on this self-help measure by 1985.

Self-help Measure: In fiscal year 1983 the Ministry of Agriculture was to reorganize in order to eliminate duplication of technical assistance with other GOCR agencies.

Status: GOCR complied with this measure. AID stated that the Ministry of Agriculture will be reorganized and

the Central Bank's technical assistance will be limited to credit activities. The Ministry of Agriculture also expects to improve coordination with other GOCR agencies and private sector organizations.

Self-help Measures: In the fiscal year 1984 agreement, the GOCR was required to strengthen the agricultural delivery system in two regions by June 1984.

Status: Proposals for agricultural centers have been submitted and reviewed by AID, and an agreement is expected by February 1985.

(4) Agricultural Policy Planning

Self-help Measure: Starting in fiscal year 1982, the GOCR was to carry out a national agricultural survey to be completed in 1983.

Status: No progress was achieved in 1982 or 1983. AID stated in 1984 that results of the survey may be available in late 1985.

Self-help Measure: In fiscal year 1984, the GOCR was to establish a mechanism for periodic national agricultural surveys, with the first survey to be undertaken by June 1983.

Status: The GOCR Census Institute has requested technical assistance from the U.S. Department of Agriculture. The first survey is scheduled for February 1985.

(5) Agricultural Credit

Self-help Measure: The GOCR was to make available in fiscal year 1982, at least \$5 million in credit to agricultural producers.

Status: No disbursements were made under the self-help measure in 1982 or 1983. However, as of January 1985, funds had been made available by the Central Bank for credit to agricultural borrowers.

(6) Export Promotion

Self-help Measure: In fiscal years 1982 and 1983, the GOCR was to undertake specific measures to promote the production and export of non-traditional exports to world markets.

Status: In reporting on the status of the 1982 and 1983 agreements, the mission stated that the GOCR had taken several actions to promote exports. Actions taken in 1982

included a number of executive decrees as part of the GOCR's effort to establish a clear policy on export promotion. They included decrees to:

- standardize and simplify export procedures;
- promote the opening of new markets for agricultural and agroindustrial products, and
- create a private sector advisory committee to present solutions to problems faced by the private sector in external commerce and recommend ways to simplify export procedures.

In 1983, the GOCR established a Ministry of Exports and Investments to establish an export policy and to coordinate public and private sector efforts to streamline export procedures. The mission stated that actions taken in 1982 and 1983 fully met the self-help measure. The 1984 self-help measure, which called for construction of facilities to export fresh fruits and vegetables, has been put on hold by the mission because fresh fruits and vegetables treated with a certain chemical (EDB) are no longer permitted in the United States.

Title I, FY 1985

The Title I self-help measures for fiscal year 1985 echo the self-help measures in the 1982-84 agreements. The GOCR is to continue efforts to promote exports, strengthen agricultural research and extension services, and implement pricing policies. New self-help measures include settlement and land distribution programs. The self-help measures in the 1985 agreement include:

- Continue selling imported commodities at prices which cover NPC costs. By April 1985, the NCP is to submit a plan to eliminate its operational deficit by June 1985.
- During 1985 the GOCR is to strengthen private sector development associations. By February 1985, the agriculture centers established in fiscal year 1984 will submit a listing of activities they will initiate during 1985-86. By March 1985 the Ministry of Agriculture will submit a program to make Costa Rica self-sufficient in grain production.
- The Agrarian Development Institute will present recommendations for its land distribution program by January 1985. The Institute will begin its land settlement activities for the Northern Zone Infrastructure Development Project.

--The GOCR will undertake a study to determine what additional facilities are required for the export of fresh produce.

AID will report on progress on these self-help measures at the end of 1985.

III HONDURAS

The study focused on the three economic assistance programs in Honduras for fiscal years 1982-85: Development Assistance, Economic Support Fund, and Public Law 480 Titles I and III. AID often uses these assistance programs to address the need for policy change and to encourage the Government of Honduras (GOH) to undertake macroeconomic and sectoral reforms. However, AID conditions its assistance on these reforms most frequently in the ESF cash transfer program.

AID has required, as part of its ESF program, specific macroeconomic reforms either as a condition precedent to disbursement of ESF funds or as a covenant. AID has met with mixed success. The GOH has been reluctant to undertake key reforms it believes will have adverse effects; and the United States has been reluctant to withhold assistance from such a politically important Central American country when conditions are not met.

Examination of six projects (five DA projects and one ESF funded project) shows that AID generally did not condition assistance on GOH reforms. Instead, AID is more frequently attempting to influence policy through the design of individual projects. The P.L. 480 program focuses on the agriculture sector and requires self-help measures to improve the efficiency of GOH institutions in this sector.

PROJECT ASSISTANCE

AID project assistance is addressing the constraints to Honduras' long-term development, including a lack of trained manpower, weak government institutions, and impediments to private sector growth. The Export Development and Services project requires policy reform action as a condition to disbursement of funds. This requirement complements AID's efforts under its ESF cash transfer program to develop a greater export capability in Honduras' private sector.

Although policy reforms can be a condition to disbursement of project assistance, AID has attempted, more frequently to advance reform through the design of the project itself. For example, the Small Farmer Titling Services project attempts to strengthen the GOH agencies responsible for transferring land titles under Honduras' land reform program. While project funds are not conditioned on a specific reform action, the project itself is supporting a major sectoral reform initiative. The Small Farmer Livestock project which is to increase the productivity of small farm livestock operations does not contain explicit policy related conditions, but does require the GOH to establish a private sector livestock fund to support private livestock

producers, prior to disbursement of funds. The project as a whole supports a broad policy objective--the transfer of government-owned farms to the private sector.

The projects we reviewed are summarized below.

1. Export Development and Services (522-0207)

--Agreement dated Sept. 1984

--\$16 million loan; \$6 million grant (life-of-project funding authorized at \$22 million)

--Agriculture, Rural Development, and Nutrition Account and Selected Development Activities Account

--The purpose of the project is to increase non-traditional exports by creating a policy environment favorable to export development and provide technical assistance to private producers.

Conditions Precedent: The GOH was required to (1) enact a Temporary Import Law; and (2) approve and implement regulations for this law and the 1983 Export Incentives Law. (Disbursement of ESF cash transfer assistance was successfully conditioned on passage of the Export Incentive Law.) The Temporary Import Law is intended to remove disincentives to non-traditional exports by authorizing temporary importation, without charges or taxes, of raw materials, machinery, and equipment needed for export production.

The GOH was also required to establish an Export Trust Fund of foreign exchange to provide financing for imports. Access to this fund by the private sector will be streamlined to encourage export development.

Status: AID officials stated that the GOH enacted the Temporary Import law in December 1984. Approval of the regulations for the Law are expected soon, according to AID officials. The regulations for the Export Incentive Law have recently been adopted. The Trust Fund has not yet been established, but mission officials expect compliance on this condition by the end of February 1985.

2. Development Administration (522-0174)

--Agreement dated Sept. 29, 1982

--\$2.5 million grant (life-of-project funding authorized at \$2.7 million)

--Education and Human Resources Development Account

--The purpose is to improve the performance of key GOH institutions responsible for tax collections, budget execution, and use of funds from international financial institutions.

There is no policy-related conditionality.

3. Small Farmer Titling Services (522-0173)

--Agreement dated Aug. 30, 1982

--\$10 million loan; \$2 million grant (life-of-project funding authorized at \$12.5 million)

--Agriculture, Rural Development and Nutrition Account

--This project intends to strengthen the GOH institutions responsible for titling rural land.

There is no policy-related conditionality.

4. Tegucigalpa Power Restoration (522-0026)

--Agreement dated Aug. 30, 1982

--\$1.8 million grant (life-of-project funding authorized at \$1.8 million)

--Economic Support Fund

--The purpose of the project is to repair and expand power substations in Tegucigalpa.

There is no policy-related conditionality.

5. Small Farmer Livestock (522-0209)

--Agreement dated Sept. 30, 1983

--\$10 million loan; \$2 million grant (life-of-project funding authorized at \$13 million)

--Agriculture, Rural Development, and Nutrition Account

--The purpose of the project is to increase the size of the national livestock herd by improving the productivity of small farm livestock operations.

There is no policy-related conditionality.

6. Small Business Development (522-0205)

--Agreement dated June 18, 1984

--\$0.6 million grant (life-of-project funding authorized at \$0.6 million)

--Selected Development Activities Account

--The project seeks to develop a source of accessible financial and technical assistance for small and medium scale entrepreneurs in Honduras. The project will help establish a small business finance company capable of providing this assistance.

There is no policy-related conditionality.

ECONOMIC SUPPORT FUND
PROGRAM ASSISTANCE

AID began providing ESF cash transfer assistance to Honduras in 1982 when Honduras faced a severe recession. The country was experiencing a critical balance-of-payments deficit as a result of falling export earnings, capital flight, and the world recession. AID has tried to address the problems of the Honduran economy by conditioning some of its ESF assistance on economic policy changes. Since 1982, AID has provided Honduras with \$121 million in cash transfers.

AID's effort to encourage the GOH to make needed reforms has been part of its ongoing policy dialogue and is reflected in conditions precedent and covenants in the ESF agreements. Several of the key policy measures AID has required are:

--an arrangement with the International Monetary Fund (IMF) to ensure sound fiscal policies and revive domestic and foreign investment;

--the expansion of exports into the world market; and,

--the improvement of GOH tax administration and tax laws to reduce the fiscal deficit.

AID's congressional presentations and annual budget submissions over the past several years have emphasized the importance of policy reform, particularly an IMF arrangement, to achieve economic stability in Honduras.

According to AID officials and documents, AID's efforts to condition assistance on policy reform have met with mixed success. The September 1982 ESF agreement and subsequent amendments

required compliance with an IMF stand-by arrangement negotiated in 1982. In November 1983, Honduras fell out of compliance with the IMF. AID then waived the conditions requiring compliance with the IMF and withheld disbursements of ESF until new conditions were formulated in a later ESF agreement. The new conditions were intended to bring the GOH closer to a new IMF arrangement. AID required the GOH to establish a Joint Economic Working Group to review GOH policies and make recommendations on needed policy reforms. The GOH met AID conditions by establishing this group and AID resumed ESF disbursements in March 1984. In June 1984, AID provided additional ESF assistance when the GOH enacted an economic stabilization package developed by the Group.

AID officials said that their ability to condition assistance on economic reform has been hampered by a number of factors. One major constraint has been GOH opposition to the IMF's requirements for a new stand-by arrangement, which would include exchange rate adjustment. AID has attempted to establish conditions which could move the GOH closer to an IMF arrangement, but the GOH is not convinced that an IMF arrangement or policy reforms necessary to obtain one will be the cure for its problems. The GOH also fears the possible adverse political and economic consequences of devaluation. U.S. security and political objectives also affect AID's strategy in Honduras. After receiving a personal appeal from GOH officials, the Administration directed an August 1984 disbursement of \$30 million in ESF assistance, waiving the condition that Honduras sign an IMF arrangement.

AID has not yet released the remaining fiscal year 1984 \$10 million ESF disbursement which has been conditioned on actions by the GOH to improve its export policies and a study by the GOH to examine Honduras' competitive position in traditional and non-traditional exports. Also, AID has not yet obligated 1984 supplemental assistance (\$72.5 million, which must be obligated by March 31, 1985) because the GOH has not agreed to AID's proposed economic conditionality.

The following is a summary of the conditionality in the ESF agreement and amendments. All information on the status of the conditions was obtained from an AID report on the ESF program compiled by the mission and from AID officials in Washington.

Economic Recovery Program (522-0230)

- Agreement dated Sept. 24, 1982
- \$51.95 million loan; \$79.05 million grant
- Economic Support Fund

--The ESF Program in Honduras was initiated in 1982 when Honduras' need for foreign exchange became critical.

The following is a summary of the conditions and covenants and their status.

Original Agreement

--Agreement dated Sept. 24, 1982

--\$35 million loan

The GOH complied with all the covenants under the agreement, according to AID.

Covenants:

--Allocate \$35 million in foreign exchange to the private sector³ and deposit local currency in a special account to support specific development activities agreed to by the GOH and AID.

--Meet the objectives of the IMF stand-by arrangement, including those required to make hard currency drawings under the arrangement and the Compensatory Financing Facility.

--Consult with AID regularly to review progress toward achieving monetary, fiscal, and balance-of-payments objectives under the ESF program and to discuss aspects of macroeconomic policy that relates to this assistance and to the objectives of the Caribbean Basin Initiative.

First Amendatory Agreement

--Agreement dated March 29, 1983

--\$3 million loan

The GOH complied with the condition precedent and covenant of the agreement, according to AID.

Condition Precedent: Compliance with the IMF agreement.

Covenant: Allocate \$3 million in foreign exchange to private producers for imports and deposit the generated local currency in a special account.

³AID requires the GOH to provide documentation that foreign exchange, at least equal to the cash transfer, is provided to the private sector for U.S. imports. This is an attribution process.

Second Amendatory Agreement

--Agreement dated July 30, 1983

--\$2.25 million loan; \$12.750 million grant

Unless otherwise noted, the GOH complied with all conditions precedent and covenants, according to AID.

Conditions Precedent:

--Compliance with the IMF agreement.

--Provide evidence that the GOH has not extended tax amnesty to delinquent taxpayers.

--Provide evidence that the Ministry of Finance has met the performance targets in the Tax Administration Improvement plan.

--Compliance with all previous covenants in the agreement.

--Implement measures to close the unprogrammed Central Government budget deficit in 1983 and to reduce the overall deficit in 1984.

Covenants:

--Conclude foreign debt renegotiations with foreign commercial banks by the end of September 1983.

Status: According to an AID official, the GOH negotiated an extension in November 1984, which runs through 1989.

--Provide sufficient domestic credit and foreign exchange for productive activities in the private sector and maintain flexible interest rate policies consistent with the principles of free market operations.

--Allocate \$15 million in foreign exchange to private producers and deposit the generated local currency in a special account.

Status: The local currency deposit was made, but documents from the Central Bank to verify that the foreign exchange equivalent was allocated to the private sector had not been provided as of September 1984.

Third Amendatory Agreement

--Agreement dated Sept. 30, 1983

--\$1.2 million loan; \$6.8 million grant

The GOH did not meet any of the conditions precedent under this amendatory agreement. AID waived all conditions and withheld disbursement until March 1984 when it established new conditions for disbursement under the Fifth Amendatory Agreement.

Conditions Precedent:

- Compliance with an IMF Agreement.
- Compliance with all covenants under the agreement.
- Meet performance targets 1 through 5 of Tax Administration Improvement Plan:
 1. reduce to 60 days processing of tax returns;
 2. prepare a monthly listing of firms which have not filed sales tax returns in the previous month;
 3. prepare a listing of individual taxpayers who did not declare taxes in 1982 but paid them in 1981;
 4. raise the annual sales levels on which sales taxes must be declared annually; and
 5. liquidate outstanding temporary import permits as of June 30, 1983.
- Evidence that GOH has implemented a moratorium on government guarantees to the private sector and limits to those granted to autonomous public institutions.
- Plan for uses of the local currency generated by the cash transfer.
- Formation of a working group to study slow disbursement of funds under international financial institution projects.
- Allocate \$8.0 million in foreign exchange to private producers and deposit the generated local currency in a special account.
- Control the fiscal deficit in accordance with Tax Administration Improvement Plan.
- Promote expansion of exports to the world market.

Fourth Amendatory Agreement

- Agreement dated Sept. 30, 1983
- \$4.5 million loan; \$25.5 million grant

The GOH did not meet several of the conditions precedent or any of the covenants to this agreement. AID withheld disbursements until March 1984 when new conditions and covenants were agreed on and met by the GOH.

Condition Precedent: Compliance with IMF agreement.

Status: Waived.

Condition Precedent: Compliance with all covenants.

Status: Waived.

Condition Precedent: Compliance with performance targets of the Tax Administration Improvement Plan.

Status: Waived.

Condition Precedent: Present to the Honduran Congress the Export Incentive Law.

Status: Met.

Condition Precedent: Analysis of GOH subsidies to autonomous institutions.

Status: Met.

Condition Precedent: Plan for the use of local currency generated by ESF assistance.

Status: Met.

AID waived the covenants under this agreement.

Covenants:

--Maintain the moratorium on guarantees to private sector firms and the limitation on those to autonomous agencies.

--Allocate \$30 million in foreign exchange to the private sector by October 15, 1984, and deposit equivalent in local currency in the Special Account.

Fifth Amendatory Agreement

--Agreement dated March 6, 1984

The purpose of this agreement was to alter the conditions precedent and covenants to disbursement of funds under the Third

Amendatory Agreement and to disbursement of \$4 million under the Fourth Amendatory Agreement.

The GOH met the conditions precedent to disbursement of funds under the Third Amendatory Agreement.

Conditions Precedent for disbursement of funds under the Third Amendatory Agreement:

--Establish a joint economic working group.

--Meet performance targets 1 through 4 of the Tax Administration Improvement Plan:

1. reduce to 60 days processing of tax returns;
2. prepare a monthly list of firms which have not filed a sales tax return in the previous month;
3. prepare a list of individual taxpayers with income in excess of \$15,000 who did not declare taxes in 1982;
4. liquidate all outstanding temporary import permits as of June 30, 1983.

--Implement a moratorium on government guarantees to the private sector and limit those granted to autonomous institutions.

--Form a working group to study slow disbursement of funds under international financial institution projects.

--Provide a completed plan for use of all local currency generated by the ESF agreement.

The GOH met some of the conditions precedent to disbursement and covenants of the \$4 million under the Fourth Amendatory Agreement.

Conditions Precedent for disbursement of funds under the Fourth Amendatory Agreement:

--Provide evidence that conditions precedent waived under the Third Amendatory Agreement have been met.

Status: waived.

--Reduce to 60 days processing of sales tax declarations.

Status: Waived.

--Complete a plan for the use of all local currency generated to date under the agreement.

Status: Met.

--Complete an analysis of subsidies to autonomous agencies and develop a plan to reduce subsidies.

Status: Met.

Covenant: Prepare a detailed report agreed upon by the Joint Economic Working Group on the fiscal situation in Honduras.

Status: Waived.

Sixth Amendatory Agreement

--Agreement dated June 11, 1984

The purpose of this agreement was to change the conditions and covenants in the Fourth Amendatory Agreement for disbursement of the remaining \$26 million.

Unless otherwise noted, the GOH met the conditions precedent and covenants, according to AID.

Conditions Precedent:

--Develop an action plan based on the recommendations of the Joint Economic Working Group and implement policy actions to bring GOH fiscal and monetary performance close to the requirements for a new 1984 IMF stand-by arrangement.

--Submit a plan for the use of local currency deposited in the Special Account.

Covenants:

--Allocate \$8 million in foreign exchange under the Third Amendatory Agreement and \$30 million under the Fourth Amendatory Agreement by October 1985 to the private sector for imports.

Status: Pending. AID has not yet received documentation from the Central Bank to verify that foreign exchange equal to the cash transfer has been allocated to the private sector for imports from the United States.

--Deposit the local currency generated by the sale of the foreign exchange in the Special Account.

--Continue to observe the following measures to improve fiscal and monetary performance:

1. Continue to disallow amnesties for payment of past due income taxes.

Status: Met.

2. Continue to implement a moratorium on loan guarantees to private sector firms, and limit those granted to autonomous agencies.

Status: Met.

3. Continue to carry out the measures implemented under the Tax Administration Improvement Plan.

Status: Met.

Seventh Amendatory Agreement

--Agreement dated July 9, 1984

--\$4.5 million loan; \$25.5 million grant

The AID mission in Honduras planned to require policy-related conditions to this \$30 million agreement which would move Honduras closer to an IMF arrangement. However, the GOH communicated its objections to such conditions and its urgent need for funds to the Administration. Disbursement of the funds without such conditions was ordered by the Administration.

Unless otherwise noted, the GOH met the covenants required by the agreement, according to AID.

Covenants:

--Maintain the moratorium in loan guarantees to private sector firms and the limits on those to autonomous agencies.

--Remain current in making interest payments, installments of principal or any other payment under any loan, guarantee, or agreement with the U.S. government.

Status: Currently, the GOH is not in compliance with this covenant. AID plans to require compliance informally before the next ESF disbursement.

--Allocate \$30 million in foreign exchange to the private sector for productive imports by July 1985, and deposit local currencies in the Special Account within 45 days.

Eighth Amendatory Agreement

--Agreement dated Sept. 26, 1984

--\$1.5 million loan; \$8.5 million grant

Disbursement of these 1984 funds is expected in March 1985. AID did not attach major conditions to this assistance because of the "small volume of resources" involved, according to AID documents. Instead, the mission is requiring the following actions which are "consonant with the magnitude of the resources." The conditions precedent have been met.

Conditions Precedent:

--Approval of regulations to the Export Incentives Law.

--Gradually replace the current outstanding issues of sight bonds, which are convertible to cash on demand, with fixed maturity bonds to reduce the expansionary impact of sight bonds on the money supply.

--Undertake a study to evaluate Honduras' competitive position in exports.

--Submit for approval by the Honduran Congress the Temporary Import Law.

The following are the covenants in the agreement.

Covenants:

--Maintain the moratorium in guarantees to the private sector and limits on those to autonomous agencies.

--Maintain payments on the external debt.

--Reduce 1985 Central Government expenditures below the 1984 level.

--Continue to observe the covenants under the ESF agreement.

PUBLIC LAW 480

Honduras received food assistance under a 2-year 1982-83 Title III agreement which totaled \$10 million and a Title I program which totaled \$22 million. The Title III Program was originally planned to run through 1984; however, because the GOH could not finance the more additional activities required under a Title III agreement, the agreement was amended to run for 2 years

only. Funds earmarked for the third year were used for a Title I agreement, with sales proceeds financing essential ongoing agricultural projects.

We examined each of these agreements for the self-help measures and status. Generally, AID's strategy in P.L. 480 is to support its overall country strategy of strengthening Honduran institutions and increasing the role and viability of the private sector with the emphasis on the agriculture sector. Many of the self-help measures complement the conditions and covenants contained in ESF agreements.

The mission, in its progress reports, stated that the Title III program was slow getting started and is somewhat behind schedule, but there has been satisfactory progress on many self-help measures. The report stated that the original Title III Agreement was developed in close consultation with GOH officials in 1981, but by the time it had been formally approved by AID in 1982, Honduras had a new government. The mission then had to renegotiate many parts of the agreement with new GOH officials which caused more delay. Reportedly, the GOH was slow to develop alternative proposals. Normal bureaucratic delays also hampered the process. In addition, some self-help measures, particularly those effecting GOH policy, were opposed by the GOH. The mission reported satisfactory progress on the Title I program, but also noted that progress on some self-help measures has been slow.

We examined every agreement and selected for study the multi-year Title III Agreement and the latest Title I Agreement. Below is a summary of the self-help measures in these agreements and their status.

Title I, FY 1984

Self-Help Measure: Continue to strengthen the Honduran National Agricultural University.

Status: The GOH has trained faculty members and developed a master plan which was expected to be approved by the end of 1984.

Self-help Measure: Increase the level of credit to agricultural cooperative associations.

Status: The mission stated that, overall, credit has been provided without the delays experienced in previous years. Liquidity problems in one organization, which was to provide medium-term credit, have been identified. AID is considering other credit channels.

Self-help Measure: Proceed with divestiture of GOH agricultural sector organizations which can operate more effectively in the private sector.

Status: AID stated that policy dialogue on this issue has been a continuing process. GOH ministers have made an informal policy commitment to pursue divestiture; however, concrete action has been slow. The GOH has analyzed divestiture of a milk plant and has made a commitment to turn it over to the producers. The mission is working with GOH officials on a reorganization to be implemented after divestiture. Also, the GOH is reviewing the transfer of a seed production operation.

Self-help Measure: Support the creation of a private sector Livestock Fund and donate two GOH-owned entities to the fund.

Status: After legal delays, the GOH took the necessary action to charter the fund. (Establishment of the fund was made a condition precedent to the Small Farmer Livestock Project.) One farm has been transferred to the fund.

Self-help Measure: Implement measures to promote greater investment in Honduras.

Status: An AID report stated that the GOH agreed to modify investment and export policies in June 1983. However, specific actions required to implement recommendations were often controversial and were resisted by the GOH bureaucracy. For example, there were delays in passing an Exports Incentive Law and approving and implementing regulations. However, action on some measures has been taken. Passage of the Export Incentives Law was a condition to a 1983 ESF agreement and was met. According to AID officials, the regulations were recently approved.

Self-help Measure: Implement forestry sector reforms.

Status: An AID report stated that the Honduran Forestry Corporation has opposed many of the recommended policy changes agreed to by the President of Honduras. Activities under this self-help measure are intended to formalize the policy commitment and set specific targets for implementing the commitment. AID mission officials are reportedly working very closely with GOH officials on this issue.

Title III, FY 1982-83

Self-help Measure: Reorganize public agricultural institutions by the end of FY 1984 to increase their ability to plan and implement agriculture sector development efforts.

Status: The mission reported that the GOH has consolidated the leadership of several agriculture sector institutions. Reorganizations of the Ministry of Natural Resources and the Agrarian Reform Institute, planned for 1984, are currently scheduled for 1985.

Self-help Measure: Improve personnel policies and salary levels of key agricultural sector institutions to improve recruitment and retain those hired.

Status: The mission reported that Honduras' economic situation does not permit the GOH to raise salaries. AID and the IMF are, in fact, encouraging the GOH to reduce expenditures. The mission recommended dropping this self-help measure.

Self-help Measure: Promote export of non-traditional crops by the private sector.

Status: During 1983, the GOH organized a joint public-private sector commission to analyze investment incentives and export promotion. The Commission submitted several recommendations to the GOH Economic Cabinet. One recommendation, the Export Incentives Law, was approved by the Honduran Congress. The mission reported that the GOH and Honduran private sector are considering other recommendations.

Self-help Measure: Support the development of a viable farmer cooperative system.

Status: The GOH has created a national committee of public agricultural entities and cooperatives to program and monitor GOH support to the cooperative sector.

Self-help Measure: Update the legal framework necessary for the national development of water resources for small farmer irrigation and drainage systems.

Status: The mission reported that the GOH Water Resources Directorate has prepared a draft water law for submission to the Congress during 1984. AID/Washington officials told us that action on the draft law is expected by March 1985.

Self-help Measure: Continue to support farmer training efforts.

Status: The mission reported that the Coordinating Committee for Farmer Training, made up of representatives from 11 GOH institutions involved in farmer training, has worked well through 1983. AID/Washington officials told us progress continues to be good. The transfer of direction from the National Planning Council to the Agrarian Reform Institute will focus the committee's work on operational issues.

IV EGYPT

Egypt's economy is burdened with several barriers to production and growth including:

- an overvalued exchange rate,
- a subsidy system that strains budgetary resources,
- price controls that hinder the effectiveness of agricultural and industrial producers, and
- restrictions on imports and exports.

The Government of Egypt has maintained these policies mostly out of concern not to reduce the living standards of urban workers.

To overcome these economic constraints, AID selectively uses conditionality in its Egypt program. Officials of both the U.S. and Egyptian governments recognize that reforms are needed to eliminate policies that distort the economy and generally prevent significant economic development. Yet the political nature of the Egypt program reduces the leverage that AID can employ.

Although Egypt has made some policy changes, AID officials generally consider these changes to be small. AID frequently discusses needed policy changes with Egyptian officials and, when it is able, places policy-related conditions on its assistance programs, but the need to obligate funds already earmarked for political purposes to the Egypt program often frustrates policy reform efforts.

PROJECT ASSISTANCE

Six projects were studied that began during fiscal years 1982-84, four of which had policy-related conditionality. Two of these projects are in the energy sector and one is in the water and wastewater sector. AID is trying to achieve more realistic pricing policies (and thus reduce subsidies) in both sectors. The fourth conditioned project seeks to promote family planning practices. One of the non-conditioned projects is attempting to help improve Egyptian policy analysis capabilities. The other is a construction project.

1. Aswan High Dam Rehabilitation (263-0160)

--Agreement dated Apr. 12, 1982

--\$85 million grant (life-of-project funding authorized at \$100 million)

--Economic Support Fund

--The purpose of this project is to rehabilitate and modernize the generation and substation facilities at the Aswan High Dam Power Station.

Covenant: Based on the tariff studies presently underway, the Government of Egypt is to implement changes in electricity prices, including those which may be required to reflect changes in fuel prices, with a view toward ensuring an adequate rate of return for the Egyptian Electricity Authority on its net revaluated assets.

Status: According to an AID official, although the Egyptians have raised electric power rates in both 1983 and 1984, these increases barely kept up with inflation, and the rates are still too low to cover costs of power generation. The Egyptians are reluctant to completely eliminate subsidies on electricity.

2. Energy Policy and Renewable Energy Field Testing (263-0123)

--Agreement dated Aug. 29, 1982

--\$7.8 million grant (life-of-project funding authorized at \$32.6 million)

--Economic Support Fund

--The purpose of this project is to help the Government of Egypt better utilize its energy resource options. One component is directed at institutionalizing the Government's capacity to collect and analyze data necessary for national energy planning. A second component will assist Egypt in collecting data on selected renewable energy field tests, which will permit Egypt to determine the feasibility of using renewable energy technologies.

There is no policy-related conditionality.

3. Safaga Grain Silos (263-0165)

--Agreement dated Sept. 25, 1982

--\$80 million grant

--Economic Support Fund

--This project provides for the design, construction, and supervision services relating to a 100,000 metric-ton

grain silo storage and off-loading facility at the Red Sea port of Safaga, Egypt.

There is no policy-related conditionality.

4. Family Planning II (263-0144)

--Agreement dated June 30, 1983

--\$20 million grant (life-of-project funding authorized at \$102.6 million)

--Economic Support Fund

--This project is attempting to strengthen Egyptian family planning systems so as to deliver effective contraceptive services to increasing numbers of married couples.

Condition Precedent: The Egyptian health ministry will provide to AID: (a) a plan to permit rapid implementation of each governorate's (a local unit of government) family planning program and (b) evidence that adequate staff are available to administer the expanded family planning program. Although this appears to be a standard administrative condition, an AID official said that it is an attempt to get a commitment to family planning from the ministry.

Status: According to an AID official, this condition precedent has not been met, and the funding for the project component related to this condition has not been approved. Funding for other components has been stopped pending the organization of a new population council and the establishment of clear population policies.

5. Ismailia Thermal Power Plant (263-0009)

--Agreement dated Aug. 9, 1983

--\$109 million grant

--Economic Support Fund

--This project provides a fourth generating unit to the Ismailia facility. Earlier, AID funded the first two units. The third unit was funded by the Export-Import Bank.

Covenant: Until a comprehensive tariff structure is implemented, the Egyptian government will ensure that an acceptable annual rate of return and a sound debt ratio will be established for the Egyptian Electricity Authority.

Status: According to an AID official, Egyptian power rates are a continuing concern to AID and a subject of policy dialogue. The Government has raised rates, but the current rate is still far below the world level. AID is willing to fund additional power projects only after significant rate increases occur. The World Bank is pressuring Egypt to reform all of its energy prices and has curtailed virtually all new energy production project commitments, with the exception of a 1984 loan to cover a shortfall in a prior investment.

6. Cairo Sewerage II (263-0173)

--Agreement dated Sept. 26, 1984

--Initial authorization is for a \$165.3 million grant, but AID agreed in a January 1984 Memorandum of Understanding to provide \$1.2 billion in water and wastewater assistance during calendar years 1982-87, pending congressional approval.

--Economic Support Fund

--This project is intended to provide the core funding for construction, design, and construction management and system operations, maintenance, management, and training activities of a wastewater collection and treatment system for the West Bank section of Cairo.

Covenant: Egyptian and U.S. representatives will meet at least annually to review the past performance and anticipated performance of the program. These reviews will serve as a basis for determining future funding levels. Reviews will include, among other things, an evaluation of the progress being achieved toward the economic targets set forth in the January 1984 Memorandum of Understanding. These were:

--the establishment of tariff increases adequate to cover the cost of water and wastewater operations, maintenance, debt service, and routine improvements, as well as appropriate increases by the Egyptian Government in the size of the operations, maintenance, and investment budgets provided to fund the sector;

--the provision of adequate facilities for training and technical services to support the sector and also an incentive system to recruit and retain qualified staff;

--the establishment of autonomous local water and wastewater organizations, with the authority to retain service revenues for their own operating needs; and

--the retention during the program of a construction management firm to ensure on-time completion of the projects.

Status: According to an AID official, Egyptian water and wastewater institutions are weak and lacking in trained personnel. Pricing policies and budgetary systems are inadequate. Although improvements (e.g., higher pay for wastewater workers, a 66 percent increase in Cairo water tariffs) have been made due to pressure from AID, Egyptian performance in this sector has been poor. AID wants significant reform before further investments are made. It has, therefore, tied fiscal year 1986 assistance to the establishment of benchmarks related to the Memorandum of Understanding. These benchmarks are currently (February 1985) being negotiated. Funding for fiscal year 1987 will depend on Egyptian performance in meeting the benchmarks.

ECONOMIC SUPPORT FUND PROGRAM ASSISTANCE

AID has had a commodity import program in each of fiscal years 1982, 1983, and 1984. The 1985 program is expected to amount to \$208 million. There was also a cash transfer grant in 1984 for \$102 million, which used deobligated funds. The 1985 cash grant is planned to be for \$100 million.

1. 1982 Commodity Import Program (263-K-604)

--Agreement dated Feb. 5, 1982

--Grant for \$300 million, later amended to \$350 million

--Economic Support Fund

--The purpose of this grant was to provide balance-of-payments support to Egypt, while at the same time contribute to Egyptian development by preserving an appropriate balance between financing capital equipment needs for long-term development and financing intermediate goods for immediate production and consumption support.

Covenant: Periodically, and not less than annually, the Government of Egypt and AID will continue to meet to discuss economic issues of relevance to grant objectives.

Status: AID officials said that this condition has been met.

2. 1983 Commodity Import Program (263-K-606)

--Agreement dated July 25, 1983

--Grant for \$300 million, amended in 1984 to \$301,055,000

--Economic Support Fund

--The purpose of this grant was similar to that of the 1982 Commodity Import Program grant.

Covenant: Periodically, but no less than twice annually, the Government of Egypt and AID will continue to meet to discuss the status of the economy, associated economic issues, and the relationship of the AID program to these concerns.

Status: AID officials said that this condition has been met.

3. 1984 Commodity Import Program (263-K-607)

--Agreement dated July 31, 1984

--\$300 million grant

--Economic Support Fund

--The purpose of the grant is similar to that of the 1982 and 1983 Commodity Import grants.

Covenant: Periodically, but no less than twice annually, the Government of Egypt and AID will continue to meet to discuss the status of the Commodity Import Program and associated economic issues.

Status: AID officials said that this condition has been met.

4. FY 1984 Program Cash Transfer (263-K-608)

--Agreement dated Sept. 26, 1984

--Grant for \$101,894,000

--Economic Support Fund

--The purpose of this grant is to promote Egyptian political and economic stability.

There are no policy-related conditions. The Government of Egypt has agreed to maintain a dollar level of non-defense imports from the United States approximately equal to the average for the prior 5 years. The Government has also agreed to budget local currency equal to the amount of the grant for the health and housing sectors. Both of the conditions have been met.

PUBLIC LAW 480

Egypt has received P.L. 480 Title I assistance in each of the years 1982 through 1984. Self-help measures have dealt primarily with agricultural policy (pricing and subsidies), agriculture research and extension, and private sector participation in the economy. A 5-year Title III agreement began in 1979 and supported the Basic Village Services program. This program promoted governmental decentralization and local institution building as a means of supporting rural development. According to AID officials, the Basic Village Services program has met or exceeded almost all of its objectives on schedule. Progress reports indicate that the program funded approximately 1,000 projects, including renewing or extending potable water systems and the construction or upgrading of rural feeder roads.

Program amounts are as follows.

--Title I: 1982, \$285 million; 1983, \$225 million; 1984, \$250 million

--Title III: 1982, \$15 million; 1983, \$15 million

Titles I and III (1982 and 1983)

Self-help measures for the Title I and Title III agreements for 1982 and 1983 were similar. The status of the self-help measures was obtained from Government of Egypt reports and discussions with AID officials. These measures required the Government of Egypt to do the following.

Self-help Measure: Review pricing policies for agricultural inputs to serve as a basis for a national system of input allocation and use.

Status: Because animal feed is in short supply, Egypt is encouraging the establishment of feed factories using non-traditional materials. Also, the private sector is allowed to import its own feed. Domestic production of nitrogen fertilizer almost meets demand but continues to be sold at a subsidized price. The importation of phosphate, potassium, and foliar fertilizers continues.

Self-help Measure: Review the subsidies on consumer prices for food items.

Status: Tests are being conducted to produce better loaves of bread at higher prices, and the private sector is being permitted to produce European-style loaves at nearly the international price. The Government has doubled bread prices.

Self-help Measure: Increase incentives for domestic food crop production.

Status: Procurement prices for wheat were increased by 20 to 33 percent. The price of onions increased 33 percent and groundnuts by 40 percent. Since 1984, prices of citrus and melons were determined by local market mechanisms. However, prices for beef, maize and cotton remain below market rates.

Self-help Measure: Identify constraints for effectively managing the agricultural research/extension/dissemination system, and develop procedures to demonstrate research to farmers.

Status: Based on a 1981 U.S. study, Egypt's agricultural research centers were reorganized in 1983 to disseminate up-to-date technological information. Furthermore, extension specialists are being trained for a new extension system. A new U.S. study is underway to identify existing constraints to the research and extension system and will examine training programs for research and extension staff. New incentives are being offered to these workers.

Self-help Measure: Identify new technologies adaptable to Egyptian farmers.

Status: New varieties of fruits have recently been introduced, and new varieties of grains are now within the technological package given to farmers by the extension service. Almost 25 percent of the rice growing area was planted with improved seed in 1984. Plans are underway for full mechanization of rice harvesting and perhaps for wheat harvesting, which include the establishment of maintenance stations. New technologies involving poultry, irrigation, and packaging are being used.

Self-help Measure: Evaluate previous agricultural research and disseminate that which is most likely to increase farm production.

Status: Egypt's agriculture ministry is attempting to implement this measure, with assistance from three AID projects: Rice Research and Irrigation; Major Cereals Improvement; and Small Farmer Production.

Self-help Measure: Develop priorities for funding research projects.

Status: Egypt is setting priorities for applied research and estimating the financial requirements of the research program.

Self-help Measure: Assess the structural and institutional options for promoting the conservation of water.

Status: A national plan for the control of water was prepared, but according to AID officials, has not been implemented.

Self-help Measure: Continue an assessment of agricultural sector investment in presently cultivated land, including previously reclaimed and newly reclaimed lands.

Status: The Government recognizes the importance of investment in both the "old" and the "new" lands. Loans are being offered for investment in the "old" lands, and there is an awareness that these lands need to be more productive.

Self-help Measure: The Government will encourage private importation of fertilizer.

Status: Increased domestic production has resulted in a great decrease in fertilizer imports. The public sector continues to dominate the import of fertilizer.

Self-help Measure: Continue discussions of ways to improve the climate for U.S. private investment in Egyptian agri-business.

Status: The Government believes that the private sector should have a greater economic role, so as to add to the resources and potentialities available for development and economic growth.

Title I (1984)

Self-help measures for the 1984 Title I agreement required the Egyptian government to do the following. The status of these measures are obtained from Government of Egypt reports and discussions with AID officials.

Self-help Measure: Reduce subsidies for maize and beef that are marketed through public sector outlets and increase the percentage of imported maize and beef that is marketed through the private sector.

Status: The Government has promised to reduce the subsidy by 47 percent and has made an agreement with private poultry farms receiving subsidized maize to deliver 25 percent of their production at the "normal" price. AID officials are not aware of further action, however.

Self-help Measure: Adjust prices for nitrogen and phosphate fertilizer sold to cooperatives so as to move the prices toward world market levels.

Status: Nitrogen fertilizer prices were raised about 7 percent in 1984. Prices of phosphate and potassium fertilizers remained unchanged.

Self-help Measure: Increase the percentage share of the private sector in the domestic marketing and distribution of fertilizer.

Status: The Government permits the private sector to import fertilizer, but provides no incentives to encourage the evolution of a private system.

Self-help Measure: Continue studies of the budgetary, nutritional, and other impacts if eligibility for subsidized commodities is reduced.

Status: The Government is negotiating with a private agency to undertake a research program that will explore the impact of consumer price subsidy adjustment alternatives.

Self-help Measure: Undertake production campaigns to increase the effectiveness of the agricultural extension service.

Status: The Government has adopted production campaigns, especially with the major cereal crops.

Self-help Measure: Bring domestic producer prices into alignment with world market prices by 1987.

Status: This measure has yet to be met.

V BANGLADESH

This study examines AID's development assistance project portfolio for fiscal years 1982-85 which totals \$312.2 million in loans and grants and the current 1982-85 Public Law 480 Title III program which totals \$284 million.

Both programs were discussed with AID/Washington officials and two AID officials who recently served in Bangladesh--one as mission director. They described the Bangladesh program as an example of effective policy dialogue, which has had measurable success. They stated that the policy dialogue between AID and the Government of Bangladesh (BDG) is a continuing effort and has resulted in important policy initiatives in the agriculture and finance sectors. In these discussions, AID officials cited several key factors to explain the program's success:

- AID, through its continued presence in Bangladesh, has built a good technical reputation and a solid reputation for understanding the country's problems.
- AID works closely with other donors to identify and pursue key policy reforms.
- BDG and AID essentially agree on the need for policy reform.
- The policy dialogue is not complicated by short-term U.S. political and security objectives.

AID officials also noted that Bangladesh's position as one of the poorest countries in the region and AID's large program combine to create a conducive environment for policy dialogue. But they emphasized that no matter how large the program, fundamental agreement on the need for policy change must exist.

PROJECT ASSISTANCE

Three DA projects begun during the period fiscal years 1982-85 were studied. AID/Washington officials said that this selection represented the core of the DA program in Bangladesh. The conditions precedent in both agriculture projects required important policy changes. The third, a population project, did not contain economic conditions; the conditions represent AID's efforts to decrease the high number of deaths previously occurring in Bangladesh's voluntary sterilization programs. The following is a description of the three projects.

1. Rural Finance Project (388-0037)

--Agreement dated Aug. 5, 1983

--\$75 million grant (life-of-project funding authorized at \$75 million)

--Agriculture, Rural Development, and Nutrition Account

--This project intends to create an economically viable financial system which mobilizes savings and provides credit to private farmers and entrepreneurs.

The project involves obligations of \$75 million in three disbursements over a 3-year period; \$24 million the first year, with \$1 million reserved for technical assistance, and \$25 million each the second and third year. The amounts disbursed, with the exception of technical assistance funds, are specifically conditioned on agreed upon financial sector policy reforms and related management improvements. Two disbursements of \$25 million each have been made. The first year disbursement was conditioned on financial sector reforms. The second year disbursement was conditioned on various management and procedural improvements. AID has not yet negotiated the conditions for the last \$25 million. The following is a description of the conditions required for each disbursement and actions taken by the BDG to meet the conditions.

Condition Precedent: The BDG was required to take specific actions relating to interest rates, rural savings mobilization; and loan recovery before disbursement of the project funds. These actions were agreed upon by AID and the BDG during the policy dialogue process; however, they were not included in the wording of the conditions precedent because of the BDG's concern about the presence of such requirements in a public document. Therefore, AID and the BDG agreed that the BDG would submit a plan outlining the actions it would take to comply with the condition precedent.

Status: AID approved disbursement of \$24 million in October 1983, after the BDG satisfied the condition precedent by implementing the following policy changes:

- increased the cost of agricultural credit to 16 percent,
- assessed a 6 percent interest charge on overdue loans, and
- applied a variable interest rate on refinancing to yield an average of 8.5 percent.

AID/Washington officials said that no formal evaluation on the effect of these reforms has been performed because it is too early to draw conclusions, but that they are developing a methodology for an evaluation later

in 1985. According to mission progress reports, however, the changes have begun to have a positive effect. The mission reported being encouraged by BDG statements and actions, and believes that policies implemented in accordance with the project's condition precedent have had a beneficial effect on the financial sector. Specifically, the mission reported that a significant development of the project has been a change in orientation of the Agricultural Development Bank towards deposit mobilization and loan recovery. The mission also stated that the decentralization of commercial banks and the BDG-encouraged expansion of private sector banking are among the favorable developments that have been, at least in part, facilitated by the project.

Condition Precedent: As a condition to the disbursement of the second \$25 million, the BDG was required to submit (1) a progress report on changes since the first disbursement and (2) a plan to further improve the financial system.

Status: A progress report, from which the above information was obtained, was submitted to the mission and reported to AID/Washington, thus meeting the first condition, according to an AID official. An implementation plan, which focuses on activities to support and complement the policy changes already implemented, was agreed to by AID and the BDG. This satisfied the second condition for the second \$25 million disbursement. AID approved release of funds in June 1984. The following summarizes activities to be carried out under the plan:

- Interest Rates - introduce a system to change rates when necessary, including establishing an interest rate advisory committee with a technical support unit and contracting an interest rate advisor.
- Mobilization of Rural Deposits - encourage rural savings through promotional campaigns and analyze factors affecting savings rates.
- Loan Recovery - require banks to provide information on overdue loans and review factors which affect repayment. Recommended changes are to be implemented before the disbursement of the final \$25 million.
- Rural Lending - review and simplify lending procedures prior to the final disbursement.
- Personnel - review personnel systems and implement new procedures before release of the final \$25 million.

- Data Systems - develop and implement a new reporting system which monitors the country's financial system before release of the final \$25 million.

A January 1985 cable from the mission shows that many activities called for under the plan are ongoing. Specifically, the cable reports that a consultant team arrived in October 1984 to work with the Bangladesh Central Bank on the various studies. With the team's assistance, work on a savings mobilization study was begun in October 1984, and the Central Bank has prepared a national savings mobilization plan. The Bank also established a technical unit and an interest rate advisory committee. The committee is to meet at least twice a year to review papers developed by the technical unit and to make recommendations. A monetary advisor began working with the technical unit created in the Central Bank's research department.

The cable also stated that the mission is developing conditions for the third and final \$25 million disbursement. They hope to begin negotiations in February 1985 with a mid-spring obligation of the funds. AID/Washington officials said that they expect a more detailed review of progress as negotiations proceed.

2. Fertilizer Distribution Improvement II (388-0060)

- Agreement dated Aug. 30, 1984

- \$65 million grant (life-of-project funding authorized at \$100 million)

- Agriculture, Rural Development, and Nutrition Account

- This project is continuing the process of privatization of fertilizer distribution begun by AID's first fertilizer project. Under the first project, a new marketing system opened up fertilizer retailing to small-scale private dealers. The current project will help establish larger scale private and cooperative wholesalers as an alternative to the inefficient public sector distribution system.

Condition Precedent: As a condition to disbursement of project funds, the BDG is required to submit to AID evidence that private distributors are legally permitted to purchase fertilizer at prices satisfactory to the BDG and AID. This project represents a significant policy shift because it involves the divestiture by the BDG of a major marketing responsibility to the private sector. The project focuses on entry of the private

sector into large scale fertilizer wholesaling. A necessary first step is for the BDG to offer private wholesalers large lots of fertilizers at wholesale discount prices from BDG sales outlets. This step is incorporated as the first condition precedent. AID expects that this shift to the private sector will eventually result in fertilizer pricing that more accurately reflects the cost of distribution. The agreement called for the condition precedent to be met by December 1984.

Status: As of February 1985, the condition precedent had not been met. AID officials explained that Bangladesh is experiencing a national fertilizer shortage, and because adequate stocks are a prerequisite to introduction of the proposed policy change, the mission has extended the compliance date. Mission officials stated that the condition precedent is expected to be met as the supply situation improves.

3. Family Planning Services (388-0050)

--Agreement dated Aug. 6, 1984

--\$26.4 million amendment to fiscal year 1981 \$64.8 million project

--Population Planning Account

--The project is intended to improve and expand the delivery of family planning services through the BDG's Ministry of Health and Population Control and nongovernmental entities.

Condition Precedent: The BDG was required to take several actions concerning its voluntary sterilization program, including the establishment of a surveillance team comprised of eight physicians to monitor voluntary sterilizations. This condition was required under the original 1981 project and was also a condition under the 1984 amendment.

Status: The surveillance team was established in November 1982, thus satisfying the condition for disbursement of funds under the 1981 project and the amendment. AID/Washington and mission officials explained that the condition precedent reflected AID's concern about the high number of deaths caused by poor anesthesia administration. AID attempted to address the problem by requiring a surveillance program funded by other donors. According to AID, there has been a significant decrease in such deaths, due in large part to the program and other AID activities, including retraining anesthesiologists.

PUBLIC LAW 480

This study examines the conditionality contained in AID's multi-year Public Law 480 Title III Program, which began in fiscal year 1982 and was recently amended to run through at least fiscal year 1985. The cumulative value of the program is \$284 million. The ongoing Title III Program addresses two primary development issues: (1) increased agricultural production coupled with improved marketing and (2) encouragement of private sector activity in the agriculture sector. To achieve these broad objectives, the Title III program requires the BDG to implement several interrelated policies over the period of the agreement designed to encourage market forces in the production and sale of food grains and gradually reduce the government's role. Generally, the program has been successful in achieving its goals. The following is a summary of the self-help measures which comprise the policy initiatives begun in 1982, and the status of these measures, according to AID's latest evaluation conducted in late 1984.

Self-help Measure: Accelerate agricultural production by establishing incentive prices, announcing prices in advance of the planting season, and maintaining the price throughout the season.

Status: The BDG has met this objective by calculating and announcing on time new procurement prices for key crops. According to the AID mission, the prices announced in 1984 were a "considerable incentive for farmers to produce."

Self-help Measure: Implement a program to moderate excessive swings in consumer prices.

Status: The BDG has continued to implement the Open Market Sales Program (OMS), agreed to by AID and the BDG as a means to moderate consumer prices during periods when market prices rise rapidly. The mission reported that the BDG's sale of foodgrain at below market prices, under the so-called "ration system," which undermines the OMS program, has been resolved satisfactorily with the BDG.

Self-help Measure: Improve the management of food grain reserves.

Status: Because of lower than expected production due to major flooding, properly managing the reserve stock was not a major issue during 1984. However, a system is in place to handle large reserves and has been used in previous years.

Self-help Measure: Phase out the food subsidy program.

Status: The mission reported continued good progress on this policy measure. The BDG continues to increase the price of foodgrains sold through the ration system bringing the cost closer to the market price. This gradual increase in the ration price eases the drain on the BDG budget. The mission reported that in fiscal year 1984 the loss on food sales from the ration system was \$9 million, down from \$86 million in fiscal year 1980.

Self-help Measure: Develop a private cotton spinning industry.

Status: The mission reported progress, stating that restrictions on private spinning mills have been lifted and the BDG is encouraging private sector participation in the industry by divesting substantial portions of public sector spinning and weaving capacity to the prior owners. As of AID's August, 1984, evaluation, 22 of 56 cotton textile facilities, about 40 percent of the industry's installed capacity, have been returned to the private sector.

Self-help Measure: Begin selling soybean and cottonseed oil through the private sector.

Status: The mission reports that the BDG continues to divest itself of vegetable oil refineries; seven of nine refineries are now in the private sector. The mission reported that it is continuing to address constraints to private marketing and processing of vegetable oil.

These policy objectives remain the principal thrust of AID's Title III program in fiscal year 1985.

VI THE PHILIPPINES

The Philippines is a major recipient of U.S. economic assistance; however, economic conditionality has not been a major element of AID's program. Beginning in fiscal year 1985, AID for the first time, is providing non-project assistance which it is using to introduce a degree of conditionality into the program. AID is also considering providing the Philippines Title I food assistance in fiscal year 1985, which would present an opportunity to encourage policy reform in the agriculture sector. The following is a brief description provided by AID officials of AID's program in the Philippines.

Economic Support Fund assistance, the largest single component in a bilateral program which includes Development Assistance and Public Law 480 Title II, is provided to the Philippines under the Philippines-United States Military Bases Agreement of 1947. Since 1979, ESF has financed development projects, especially in the areas around the military bases, which respond to the basic needs of the Philippine people. More recently, fiscal year 1984 ESF project assistance was made available nationwide rather than mostly to the areas around the bases.

In AID's 1983 review of the Base Agreement, AID decided to commit at least half the annual ESF assistance in the 1985 agreement, to non-project or "program assistance." The new ESF package of \$475 million is set for fiscal years 1985-89. By its nature, program assistance lends itself more to policy leverage; AID officials explained that previously AID had not incorporated conditionality into ESF project agreements, principally because the ESF assistance was linked directly to U.S. access to the bases--in other words, the funds are considered "rent money" by the Philippines. This, and the fact that the assistance level is specified for 5 years, decreases AID's ability to place conditions on assistance.

AID is using program assistance for the first time in fiscal year 1985, providing \$47.5 million in budget support to help complete development projects already in progress and relieve the Philippines' balance-of-payments problem. The new program assistance adds some degree of conditionality. The Government of the Philippines (GOP) is required to spend some of its own resources as well as local currency generated by the \$47.5 million cash transfer to firmly budget funds for multilateral and AID development projects which have been left unfunded in the Philippines' economic crisis.

AID officials explained that although this conditionality does not require economic reform, it is nevertheless an important step. In effect, the United States has begun to show a reluctance to disburse ESF assistance "blindly" and is instead

requiring the Government to take actions AID believes necessary for the success of donor development projects. Over the past year and a half, AID has also occasionally stopped disbursements of ESF project funds pending improvement in the GOP's project implementation performance. AID officials stated that conditionality can be more difficult in countries in which the United States has clear political and security interests. However, they pointed to the Philippines as a case where AID is learning to balance the importance of these interests against the need for policy reform.

AID uses Development Assistance funds to encourage policy reform. AID officials explained that AID has not placed reform-related conditions precedent on DA projects because of the relatively small size of the program and because the projects themselves do not provide AID with much leverage. However, AID officials informed us that DA projects support policy initiatives developed through policy dialogue between the GOP and AID and other donors. Also, AID is moving to a sector type program in fiscal year 1985 which should lend itself to more explicit linkages to policy reform in agriculture, according to AID officials.

AID is considering providing the Philippines food aid under the P.L. 480 Title I program. According to AID, actual provision of this assistance is contingent upon the availability of Title I resources and an agreement between AID and the Philippines on a package of economic reforms. The latter is the more formidable barrier, according to AID officials. Although AID would like to provide the food assistance, it is not interested in doing so without the necessary policy commitments from the Philippines. AID told us that discussions on specific reform measures are ongoing, but marketing and production policies would most likely be among those targeted in an agreement.

VII SUDAN

Sudan faces serious economic problems, among them a large (approximately \$300 million) balance-of-payments deficit and mounting international debt. Concern about these problems has led the U.S. government to attempt to assist Sudan in reforming its economic policies. This effort has been undertaken through policy dialogue (in association with other donors), through studies that explain and justify the reforms, and through conditioning of AID assistance, especially that provided through the Economic Support Fund and the P.L. 480 Program. Despite these efforts, Sudan's economy has stagnated. AID has withheld disbursement of \$82.5 million of the 1984 Commodity Import Program until Sudan meets certain administrative conditions precedent and undertakes comprehensive reform of its economic policies. Disbursement of 1985 Commodity Import Program assistance, now under review by AID and expected to total \$111 million, depends on disbursement of the 1984 assistance. AID's action does not effect DA and P.L. 480 assistance.

The Sudanese government has made an effort to reform its policies. For example, policy changes during 1984 included the removal of sugar and bread subsidies; the establishment of higher producer prices of gum arabic, sesame, and groundnuts; the devaluation of the bank exchange rate by 17 percent; the reduction in money supply growth; and the establishment of credit restraints leading to a reduction in the balance-of-payments deficit. Nevertheless, the economic climate in Sudan leaves much room for improvement. The private sector is generally distrusted, the Islamization⁴ of the economy has not given encouragement to investors, price controls and subsidies still exist for some items, and exchange rate reform is still necessary.

PROJECT ASSISTANCE

Six projects initiated during fiscal years 1982-84 were studied. Only two of the projects had conditionality, though a third project is attempting to improve Sudanese capabilities to undertake policy reform.

1. Southern Agricultural Development I (650-0046)

--Agreement dated Aug. 31, 1982

--\$6.98 million grant (life-of-project funding authorized at \$10.1 million)

--Agriculture, Rural Development, and Nutrition Account

⁴Since September 1983, Sudan's legal system has been based on Islamic law, which has also had an impact on the economy.

--The project is intended to promote increased agricultural production and incomes in Sudan's southern region by relieving key constraints to private sector agricultural production, processing, and marketing activities. Components of the project are as follows:

--agricultural marketing, which includes assistance in undertaking agricultural policy reform;

--farm research;

--manpower development and utilization, aimed at regional agriculture ministry personnel;

--budget and financial planning, designed to strengthen ministry financial capabilities; and

--area development, which includes establishment of credit programs, improvements in market activities, and construction of feeder roads.

There are no policy-related conditions.

2. Energy Planning and Management (650-0059)

--Agreement dated Aug. 31, 1982

--\$1.555 million grant (life-of-project funding authorized at \$8.45 million)

--Special Development Account

--The project seeks to ease energy related constraints to economic recovery while contributing towards the long-term goal of meeting Sudanese energy requirements for domestic, agricultural and industrial uses in ways that are economical, efficient, and environmentally sound. Towards this goal, the project will:

a. increase the short-term reliability of the Blue Nile Electric Power Grid and improve the managerial and financial capability of the National Electricity Corporation to generate, transmit, and distribute power and

b. improve the capability of the National Energy Administration and the General Petroleum Corporation to plan programs and implement strategies for the most efficient use of Sudan's energy resources.

These organizations are all components of the Sudan Ministry of Energy and Mining.

Covenant: The Government shall keep AID informed of all donor funded activities at the National Electricity Corporation and convene an annual donor coordination meeting.

Status: The Government has met this covenant to some extent, according to an AID official. However, the National Electricity Corporation has had several acting directors-general since the fall of 1984 and thus has lacked the strong leadership needed for effective coordination.

Covenant: The Government will encourage, as much as possible, private sector efficiency and participation in energy planning.

Status: According to an AID official, little progress has taken place. There is optimism, however, that a new chief-of-party for the AID contract team will speed progress on this issue.

Covenant: AID and the Government will undertake a detailed socioeconomic analysis of Sudanese energy pricing policies.

Status: This covenant has been partially met, according to an AID official. The Government sees the need for pricing studies and some are underway. A study of diesel fuel is complete.

3. Model Family Planning (650-0063)

--Agreement dated Sept. 27, 1982

--\$596,000 grant (life-of-project funding authorized at \$1,796,000)

--Population Planning Account

--This grant to the Sudan Fertility Control Association, a private, voluntary organization, is being used to support a family planning clinic.

There are no policy-related conditions.

4. Southern Region Road Maintenance and Rehabilitation (650-0043)

--Agreement dated Aug. 27, 1983

--\$18.237 million grant (life-of-project funding authorized at \$19.7 million)

--Agriculture, Rural Development, and Nutrition Account

--This project consists of road rehabilitation and maintenance activities in the Equatoria and Bahr El Ghazal regions of Sudan.

There are no policy-related conditions.

5. Policy Analysis and Implementation (650-0071)

--Agreement dated Aug. 31, 1983

--\$2 million grant (life-of-project funding authorized at \$5 million)

--Economic Support Fund

--The purpose of this project is to assist the Government of Sudan with its macroeconomic policy reform efforts by (1) undertaking analytic studies of national policies for economic development in collaboration with Sudanese institutions and experts; (2) facilitating dialogue on national economic issues and policies among Sudanese experts and the international development community; (3) developing recommendations to strengthen macroeconomic policies for consideration by the Government, AID, and international development institutions; and (4) taking initial steps through analysis and technical support to encourage changes in Sudanese policies such as foreign exchange markets and privatization.

There are no policy-related conditions. However, the project has generated a number of studies that explain the need for policy reform and demonstrate what actions can be taken. This, and the fact that ministry officials are involved in the studies, makes lasting reform more likely, according to an AID official. A study of diesel fuel prices may lead to reform, and a study of the exchange rate formula for several export commodities has led to a change in the formula.

6. Western Sudan Agricultural Marketing Road (650-0069)

--Agreement dated Aug. 30, 1984

--\$15.7 million grant (life-of-project funding authorized at \$60 million)

--Agriculture, Rural Development, and Nutrition Account

--The purpose of this project is to construct and provide maintenance for an all weather road from Tendelti to El

Obeid (a distance of 115 miles). The African Development Bank will fund a road from Tendelti to Kostti (a distance of 72 miles). El Obeid is a major agricultural marketing center and Kostti is an important rail, river, and highway transportation center.

Covenants: One policy-related covenant states that the Sudanese government will provide information to AID concerning the adoption and enforcement of vehicle size and axle-load regulations, and will allow AID the opportunity to consult with the Government about the regulations. A second covenant calls for the Government to convene an annual meeting of all transportation sector donors, so as to coordinate donor activities and review Government transportation sector policies.

Status: AID is concerned that without adequate Sudanese maintenance capabilities, this road (and others) will eventually deteriorate. AID has discussed with the Sudanese government the possibility of making this a toll road, which would pay the costs of road maintenance. AID also wants to be a party to Sudanese discussions with the World Bank concerning its current road project. AID officials in Washington are not certain if the first covenant has been met. It is too early, according to these officials, for the second covenant to have been met.

ECONOMIC SUPPORT FUND PROGRAM ASSISTANCE

AID has extensively used its ESF programs to influence economic policy in Sudan. Since the mid-1970's, Sudan has been experiencing an increasingly severe foreign exchange crisis brought on by lagging exports, poor administration, out-migration of skilled workers, and unfavorable international prices. Furthermore, Sudanese economic policies have made the situation worse, and the ongoing drought further aggravates the balance-of-payments situation. AID, the International Monetary Fund, and other donors have sought change in those economic policies that restrict development. Nevertheless, the foreign exchange situation remains intolerable and per capita income has stagnated. The need continues for economic policy change.

1. FY 1982 Commodity Import Program (650-K-603)

--Agreement dated May 14, 1982

--Grant for \$100 million

--Economic Support Fund

--The purpose of this program was to finance the foreign exchange costs of certain commodities and commodity-related services necessary to assist the Sudan in meeting a serious foreign exchange shortage, achieve development objectives, and improve its standard of living.

Covenant: No less than 60 percent of the proceeds of the grant will be made available to the private sector.

Status: This covenant was nearly met, according to an AID official. Roughly 50 percent of the grant proceeds were made available by the Sudanese government to the private sector.

Covenant: This grant supports Sudan's economic stabilization program. Sudan agrees to periodically meet with AID to discuss economic issues and to execute the economic stabilization program. Under this program, the Government of Sudan promises:

- (a) to execute to the best of its ability the economic stabilization program associated with its stand-by arrangement with the International Monetary Fund under which the Government will reduce government expenditures and borrowing, establish more realistic exchange rates, and align prices and interest rates to realistic market rates;
- (b) to review the management of public enterprises in the agriculture and agro-industrial sector in order to determine ways to improve efficiency in operations and investment policy decisions;
- (c) where indicated by such reviews and where considered necessary to achieve development objectives, to make progress towards phasing out inefficient public enterprises with first priority in the agriculture sector which is vital to economic growth;
- (d) to issue regulations in implementation of the new investment code and undertake other measures in order to encourage foreign and domestic private investment in developing the economy, particularly in agriculture;
- (e) to increase emphasis on management and technical training programs and establish compensatory and/or other measures to encourage retention of technically qualified personnel in agriculture and related industries;
- (f) to review government policy reforms necessary to encourage increased private savings and investment, particularly from Sudanese working abroad; and

(g) to review foreign exchange allocation and the import licensing system to assure that they function efficiently and fairly in addressing needs of the private sector, consistent with public policy in establishing priorities for use of limited resources.

Status: The provisions related to the economic stabilization program have been partially met as follows, corresponding to the list above:

- (a) Sudan met the International Monetary Fund conditions.
- (b) AID never received a study of this issue, but the subject was addressed in the Three-Year Public Investment Plan.
- (c) A list of public enterprises to be abolished or privatized was prepared, though little action has been taken to actually phase out parastatals. Although action has been taken to privatize the national airline, sugar mills, several textile firms and some irrigated farms, the public sector continues to grow faster than the private sector.
- (d) According to AID officials, little has been done. Private firms face rising production costs, yet the Government has been slow to raise controlled prices.
- (e) Sudan pays its civil servants poorly, and many get higher-paying jobs in the Arabian peninsula countries. This condition was partially met--the Government is paying a differential to its agriculturalists in remote locations.
- (f) This condition was met--a study was completed.
- (g) Foreign exchange allocation and the import licensing system were reviewed and some adjustments were made.

2. 1983 Commodity Import Program (650-K-604)

--Agreement dated Jan. 9, 1983

--Grant initially for \$30 million, later amended to \$60.25 million

--Economic Support Fund

--The purpose of the grant was to finance the foreign exchange costs of certain commodities and commodity related

services necessary to assist Sudan in meeting a serious foreign exchange shortage, achieve development objectives, and improve its standard of living.

Covenant: The grant supports Sudan's budgetary and foreign exchange requirements related to its Three-Year Public Investment Program and Policy Action Program, together with the Government's undertaking under its stand-by arrangement with the International Monetary Fund. Sudan agreed to discuss economic issues with AID and to execute and to keep AID informed of progress concerning its various economic recovery programs. Specifically, the Government agreed:

- (a) To the extent that it controls the prices of import-related goods and services, and with the exception of wheat/wheat flour and medicines for which controlled prices will be so increased by the end of 1983, the controlled prices will be maintained at levels that reflect the prevailing rate of exchange.
- (b) To continue its review of revenue policy and procedure and initiate measures to reform its tax structure (especially with regard to indirect taxes, such as customs, tariffs, excise and consumption taxes, development sales taxes, and related levies) to ensure the collection of adequate domestic revenues to meet its economic stabilization objectives.
- (c) To continue to review its foreign exchange and import licensing systems to ensure that they function effectively in meeting the needs of the private sector, consistent with the priorities established for the use of Sudan's limited foreign exchange resources.
- (d) To determine and institute policy reforms necessary to encourage increased private savings and investment, particularly from Sudanese working abroad.
- (e) To issue regulations in implementation of its investment code and undertake other measures necessary to encourage foreign and domestic private investment in developing the economy, particularly in agriculture.
- (f) To continue to review its policies and procedures relating to the import and distribution of petroleum products and, as determined appropriate, increase private sector participation in the import and distribution thereof.

Status: The provisions related to the economic recovery programs have been partially met, according to AID officials, as follows, corresponding to the list above.

- (a) This condition was met. By late 1983, retail price controls were confined to a few essential consumer and producer goods. Exceptions included petroleum, sugar, wheat and wheat flour, and life-saving pharmaceuticals, which were imported at the official, rather than the free market, exchange rate.
- (b) A review of revenue policy and procedure was completed. However, an effective tax collection system is not in place. Furthermore, the Islamization of the economy resulted in the abolition of personal and corporate income taxes and excise duties. These were replaced with a flat-rate religious tax. Income taxes and excise duties have since been reintroduced and corporations have been exempted from the religious tax.
- (c) The Government continued to review its foreign exchange and import licensing systems. Between 1978 and December 1982, Sudan devalued its currency by almost 70 percent. However, the exchange rate system continued to work against the private export sector, where 75 percent of export proceeds were converted at the low official rate. Import licensing remains a problem.
- (d) Actions to encourage remittances for Sudanese workers abroad include establishment of a financial institution in Saudi Arabia through which remittances can be processed and remittance incentives made to the workers.
- (e) Islamic law has made the investment climate uncertain.
- (f) This condition led to the petroleum initiative in the 1984 Commodity Import Program.

3. 1983 Program Grant (650-K-605)

--Agreement dated Dec. 27, 1982

--\$20 million grant

--Economic Support Fund

--The principal objective of this cash transfer grant was to bridge the gap between the announcement of difficult and politically sensitive policy reforms and generation of revenues from either Sudan's own resources or disbursements from other donors.

The covenants of this grant are similar to those of the 1983 Commodity Import Program and whatever actions were taken to meet the covenants are discussed in the status sections above.

4. 1984 Commodity Import Program (650-K-606)

--Petroleum Initiative Agreement dated June 9, 1984, and Commodity Import Agreement dated Aug. 26, 1984

--\$40 million Petroleum Initiative grant and \$62 million Commodity Import grant

--Economic Support Fund

--The objective of the Petroleum Initiative grant is to assure a sufficient and reliable supply and establish an efficient system for the financing, procurement, importation, allocation, and distribution of petroleum products into the Sudanese economy. This will be achieved as a cooperative effort including the Government of Sudan, a number of bilateral and multilateral donors, private oil marketing companies, and AID. The end result is to be a decrease in the balance-of-payments gap by as much as \$60 million annually insofar as the grant is to enable the government to (1) purchase petroleum supplies at cheaper prices and on better terms and (2) end petroleum shortages and black markets that inhibit domestic production, reduce export earnings, and hamper import substitution. The Commodity Import grant is to provide foreign exchange for other essential public and private sector imports.

The U.S. government continues to be concerned about Sudan's economy and wants to see significant steps taken toward reform. Because Sudan has not met all conditions precedent and not taken necessary reform actions, AID has not disbursed 1984 Commodity Import Program funds. The only exception has been an emergency disbursement for sorghum seeds and jute--two critically needed agricultural commodities.

Petroleum Initiative grant

Condition Precedent: The Government of Sudan will prepare a plan for the importation and allocation of petroleum products involving private distributors.

Status: A committee of Sudan government and private distributors has met and prepared a plan.

Covenant: The Government will study, with the World Bank, the relative prices of petroleum products and their effects on production and exports, and take appropriate actions based on the study. Among these actions will be the establishment of diesel fuel prices which reflect its costs.

Status: A study was prepared with the World Bank. A subsequent AID study has convinced the Sudanese to raise diesel fuel prices.

Covenant: The Government will institute a pricing system that allows internal distributors of petroleum products to recover costs.

Status: The Sudanese have agreed to this covenant pending disbursement of the Petroleum Initiative grant. Prices will be raised to free market levels.

Covenant: When the supplies of various petroleum products are meeting demand at import parity prices, the Government will discontinue its allocation system for the sale and internal distribution of the particular product.

Status: The Sudanese have agreed to this covenant pending disbursement of the Petroleum Initiative grant. An exception is that the Government will allocate fuel to the major agricultural areas, to be delivered by private dealers. Otherwise, the free market will be allowed to work.

Commodity Import grant

Covenant: The Government of Sudan will initiate steps leading to an adjustment in the official exchange rate so as to encourage exports and make more efficient use of imports.

Status: Exchange rates have been reformed for many items, but some commodities still are subject to unfavorable rates.

Covenant: The Government will eliminate the 15 percent discount applied to all commodities imported under "protocols, aids and commodity-financed agreements." The commercial bank rate will apply for deposit of local currency by all importers.

Status: The discount has been eliminated.

Covenant: The Sudanese National Electricity Corporation will reduce losses in the system incurred between generation and sales to 25 percent or less.

Status: The Government has raised electricity prices several times in the last 2 years, but bill collection has been "abysmal," according to U.S. officials.

5. 1984 Program Grant (650-K-607)

--Agreement dated Feb. 19, 1984

--\$18 million grant

--Economic Support Fund

--The purpose of this cash transfer grant is to help Sudan minimize a severe balance-of-payments problem and undertake an array of difficult policy reforms.

Covenants: The Government of Sudan will make across-the-board budgetary reductions of 7 percent to be achieved by a hiring freeze, a payroll review, and restrictions on vehicle expenses; and will raise additional revenues by raising the defense tax on imports and by doubling the tax on Sudanese working abroad, which will be collected in U.S. dollars. Furthermore, in order to encourage decentralization of government operations and encourage greater local initiative, the Government will delegate more authority to regional governments to raise local taxes.

Status: AID/Washington officials told us that the mission had informed them that these covenants had been met but had not provided detailed information.

PUBLIC LAW 480

The Government of Sudan has taken some positive steps, as part of its P.L. 480 program, to reform its economic policies, including (a) eliminating export taxes on most agricultural commodities, (b) eliminating subsidies on wheat products, (c) increasing floor prices on some domestic commodities to achieve parity pricing, and (d) increasing private sector involvement in wheat procurement. Many of these reform measures have been undertaken in association with Sudan's 1979 agreement with the International Monetary Fund. AID considers P.L. 480 to be a useful policy reform instrument and enjoys a certain amount of leverage because of the Sudanese need for wheat.

Nevertheless, some P.L. 480 self-help measures have not been complied with. AID officials say that this is due, in part, to weak Sudanese government institutional capacity. Also, policy reforms can be politically sensitive. For example, wheat is a staple of urban dwellers, and thus the Government is very cognizant of the sensitivity of urban populations to changes in wheat prices. Additionally, Sudan has been experiencing a severe drought in recent months that has caused those actions related to food exports and stocks to be temporarily irrelevant. Furthermore, Government distrust of the private sector is strong.

1. Title I

--1982, \$5.0 million

--1983, \$30.0 million.

--1984, \$30.0 million.

The Title I agreements call for the Government of Sudan to undertake the following self-help measures.

Self-help Measure (1982): Maintain groundnuts, edible oil, and sesame free of export duties.

Status: Taxes on exports were removed or greatly reduced.

Self-help Measure (1982): Maintain a weekly/monthly reporting system for monitoring stocks and maintain wheat stocks at adequate levels.

Status: The analytical unit of the Ministry of Commerce has been strengthened to allow activities to be completed on a timely basis. A computer system is being developed to monitor grain stocks; however, because of the drought, stocks are very low. Further progress on this measure may be hindered due to reprioritization of activities caused by the drought.

Self-help Measure (1982): Keep trade and exchange policies under surveillance so that domestic food is favored over imported food.

Status: Producer prices of some crops have been brought into line with international prices.

Self-help Measure (1982-83): Eliminate the consumer price subsidy for wheat/wheat flour products by December 15, 1983.

Status: The Government removed the explicit wheat subsidy 5 months ahead of schedule. The implicit subsidy caused by an overvalued exchange rate has also been eliminated.

Self-help Measure (1982-83): Increase private sector participation in wheat/wheat flour importation. This would be done by licensing private import with foreign exchange from the banking system at the official rate of exchange.

Status: According to an AID report, under present administered prices, there remains a disincentive for the private sector to import wheat unless the private sector could have access to foreign exchange at the official rate. Otherwise, private dealers would have to sell at a loss. The Private Sector Millers Association was established in 1984 and allowed to import and distribute wheat/flour. AID believes that the Government is willing to make the necessary concessions which would provide adequate financial incentives to the private sector.

Self-help Measure (1983): Increase emphasis on management and technical training programs and establish measures to retain qualified personnel in agricultural industries.

Status: The Government of Sudan claims that with donor technical assistance, it has been giving increased attention to technical and vocational training. The goal is to have training centers in each region. The Government has revised the salary structure to retain technicians, although an AID official has said that further revision may be necessary.

Self-help Measure (1983): Review public and parastatal corporations engaged in agricultural production and marketing, and develop a plan to transfer selected enterprises to private sector ownership and operate other public enterprises more efficiently.

Status: According to AID, although the Government has made some superficial moves toward private sector initiatives, it has an institutional distrust of the private sector. There is no long- or short-term plan to shift public enterprise and functions to the private sector, except on an ad hoc basis. It is AID's view that the Government is moving towards, not away from, government control of business, including agriculture.

Self-help Measure (1983): Review agricultural incentives and announce pre-planting producer prices for farmers that are at parity with import prices.

Status: The pre-planting announcements were made after planting when farmers were no longer able to respond to price changes.

Self-help Measure (1983): Determine the economic feasibility of private sector investment in sorghum milling capacity and the blending of composite wheat/sorghum flour.

Status: This self-help measure is proceeding satisfactorily, according to AID officials. AID and the Government are proceeding with a plan for private participation in commercial tests of breads made with wheat and sorghum. However, sorghum shortages caused by the drought have hampered this effort.

Self-help Measure (1984): Investigate the feasibility of multiple bread pricing.

Status: No action has been taken regarding the study of multiple pricing policy.

2. Title III

--1982, \$20 million

--1983, \$20 million

--1984, \$20 million

Some Title I and Title III self-help measures are similar. The following are unique to the Title III agreements.

Self-help Measure (1983): Promote private sector participation in river transport operations. Study private sector perceptions regarding constraints and opportunities to establishing such enterprises and establish a licensing system for private firms by December 1983.

Status: River transportation has been opened to the private sector, and the Government has established a licensing system. Several private companies have applied for licenses. However, recent disturbances in southern Sudan (including attacks on river traffic) have discouraged private operators.

Self-help Measure (1983): Improve the operations of Sudan railways. Undertake a study of managerial, institutional, and financial constraints of Sudan's railway system by April 30, 1984.

Status: AID officials said that railway tariffs have been increased, but an effectiveness study has not begun. As with many rail systems, political concerns often override good management practices.

Self-help Measure (1984): Contract with Gezira Trading Company for receiving, clearing, and storing of the wheat financed by this agreement. Allow millers to contract with private sector transporters for inland transportation.

Status: Sudan has a Military Economic Board which the Sudanese Government considers to be private sector, but which AID considers to be public sector. Wheat, under the 1983 agreement, was handled by a parastatal initially under the jurisdiction of a ministry, but later assigned to the Military Economic Board. The parastatal's performance was poor. AID, to avoid working with the Board, insisted that the 1984 wheat be handled by the Gezira Company, a parastatal not associated with the Board. Wheat, under the 1985 agreement, is to be handled by the private sector.

Self-help Measure (1984): The public sector will not sell wheat, flour, or bread at a price less than that of the private sector, nor receive foreign exchange for the purchase of wheat at less than the rate available to the private sector.

Status: The Military Economic Board owns the largest bakery in the Sudan and AID does not want private bakeries underpriced by the Board. Import parity prices for wheat have been agreed to, but because of the drought, no new prices have been announced.

Self-help Measure (1984): Maintain a flexible wheat/flour and retail pricing policy, such that no explicit or implicit subsidy will emerge.

Status: Explicit and implicit subsidies have been removed, and this measure is aimed at maintaining market pricing.

Self-help Measure (1984):

--Set the floor price for domestic wheat at parity with imported wheat, including shipping and handling costs.

--Recommend an increase in the floor price for groundnuts in regional auction markets so as to increase exports.

--Increase the floor price for gum arabic in regional auction markets by not less than 25 percent.

Status: Pricing for locally grown products is headed in the right direction but not in sufficient magnitude, according to AID. Although the 1984 wheat crop achieved parity pricing and groundnut and gum arabic prices were raised, most commodities remained priced at nonparity prices.

Self-help Measure (1984): Collaborate with AID on a study of pricing policy for domestically produced agricultural commodities and industrial goods.

Status: AID officials did not know if this study has been undertaken.

Self-help Measure (1984): The private sector will be allowed to participate in procurement and distribution of all wheat/flour purchased under future P.L. 480 agreements. The private sector will have equal access to all public sector facilities.

Status: According to AID officials, the private sector millers' association will handle procurement and distribution and will have equal access to public sector facilities.

3. 1985 Title I Agreement

The 1985 Title I Agreement for \$25 million worth of wheat and wheat flour (soon to be followed by a second tranche worth \$25 million) was signed on December 27, 1984. The Agreement contains the following self-help measures.

- Facilitate to the fullest extent possible the importation and internal transportation of P.L. 480 commodities by the new private sector millers' company, which will assume responsibility for handling Title I purchases in fiscal year 1985.
- Only after prior consultation with, and advice from AID, will the Government substitute wheat or wheat flour for sorghum in the emergency program established to assist the victims of the current drought in Sudan.
- The Government agrees to give highest priority in programming the local currencies to be generated by the Title I sales program to support development projects whose primary objective is to reduce the vulnerability of agricultural production to the drought, and to preserving the base for economic development by supporting drought related projects, including financing the transport of commodities provided by donors.
- A joint Government/AID study will be undertaken, based upon the results of the current commercial composite flour trial which is expected to be completed during May 1985, which will update the 1983 study on the economic feasibility of implementing composite flour in bread making.
- Take steps to curtail the increase in wheat consumption.
- The Government and AID agree to undertake a study to evaluate the benefits and costs associated with the current 10 month payback period for wheat/flour purchases.

It is too soon for any significant action to have been taken on these measures.