THE A.I.D. ECONOMIC POLICY REFORM PROGRAM IN THE GAMBIA

A.I.D. IMPACT EVALUATION REPORT NO. 76

by

Jan H. van der Veen, Team Leader/Economist
(Agency for International Development)

Thomas D. Hobgood, Agricultural Economist
(Agency for International Development)

Melanie J. Marlett, Social Analyst
(Agency for International Development)

Joseph M. Lieberson, Policy Reform Evaluation Coordinator
Center for Development Information and Evaluation
U.S. Agency for International Development

August 1990

TABLE OF CONTENTS

FOREWORD

The Agency for International Development/Center for Development Information and Evaluation (A.I.D./CDIE) has launched a series of impact evaluations to learn more about the effectiveness and developmental impact of A.I.D.'s economic policy reform programs. Six country studies have been completed in Central America and the Caribbean (Costa Rica, Jamaica, Honduras, the Dominican Republic, and Dominica and Grenada). In Africa evaluations have been completed in Mali, Senegal, Malawi, Cameroon, and Uganda, as well as The Gambia.

This evaluation, which is based on fieldwork completed in October 1989, analyzes the A.I.D.-supported economic policy reform program in The Gambia over the 1987-1989 period. These reforms built on, and extended to the sectoral level, a set of major economic stabilization and structural reforms in which The Gambia successfully closed large and unsustainable balance of payments and budget deficits, while sharply reducing inflation.

The A.I.D.-supported policy reforms focused on finance (interest rates, lending policy, and access to credit) and agricultural marketing (competition in groundnut marketing). Although the sectoral reforms were implemented in a timely manner, their impact has not been immediately apparent. Necessary changes were made in policy and regulations to introduce equitable practices in finance and competition in groundnut marketing. But the private sector was slow to respond to the policy changes. The major reason for the poor response of the private sector was that the required complementary institutional changes proved difficult to accomplish.

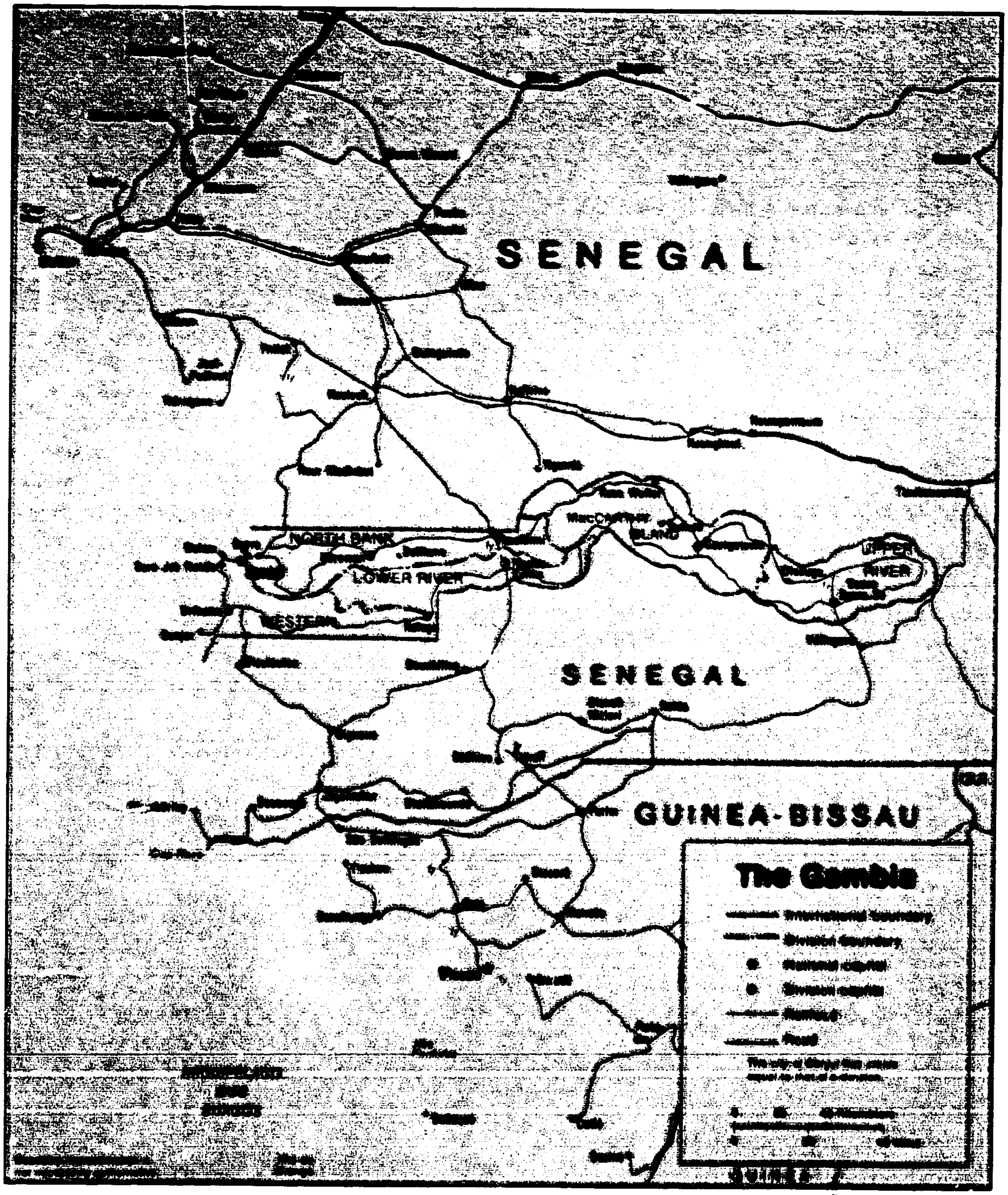
Transforming institutions requires an adequate time frame (the sectoral reform program began a scant 2 years before the impact evaluation team conducted its fieldwork); extensive technical assistance; and a deep understanding of complex relationships between policy reforms, institutions, and sets of individuals--three elements that were not in place in The Gambia. Thus, as of the time of this evaluation, the impact of these sectoral reforms has been minimal. Despite these results, there are a number of indications that the reforms are starting to take hold and that positive impacts may become evident in the not too distant future.

John Eriksson
Associate Assistant Administrator
Center for Development Information
and Evaluation
Bureau for Program and Policy Coordination

-^N-

Agency for International Development

August 1990



Base 801133 (B00540) 12-88

SUMMARY

From the mid-1970s to the mid-1980s, The Gambian economy suffered a steady decline. The country's terms of trade worsened as the price of groundnuts (the major export) fell and the price of imported petroleum products increased. In addition, the government budget went from a small surplus to a rapidly growing deficit as civil service employment expanded and government parastatals incurred losses. By 1985 the economy was grinding to a halt because of a major balance of payments crisis, an unsustainable budget deficit, rapid inflation, and a general loss of business confidence.

In 1985, the Agency for International Development (A.I.D.), along with the World Bank, International Monetary Fund (IMF), and other bilateral donors, supported a major economic reform program--a program that has had a striking impact on the Gambian economy. The effort quickly stabilized the economy and, after only 1 year, began a growth spurt that is still continuing.

In 1987, as part of the overall reform program, A.I.D. provided The Gambia with a $6 million grant to support a series of sectoral reforms. The policy conditionality of the grant focused on a set of financial and agricultural marketing reforms

designed to encourage greater private sector involvement in productive activities and discourage the Government from regulating and controlling activities that could most efficiently be done by the private sector. The Government of The Gambia agreed to the following reforms:

-- To develop and implement appropriate policies with respect to term lending, agricultural credit, and development lending

-- To ensure that all borrowings from official sources are at market-determined interest rates

-- To ensure that no public sector institution grants preferential access to credit

-- To ensure that allowances--fees intended to cover trader's margins--for all buyers (public and private) involved in agricultural marketing are equal

These reforms were designed to end the flow of subsidized credit to government parastatals and to end the repression and control of financial markets. It was expected that the reliance on appropriate interest rates and the removal of administrative credit allocations would encourage savings, stimulate efficient investment allocations, and end capital flight.

In the area of groundnut marketing, the Gambia Cooperative Union had been receiving higher buying allowances (purchase price adjustments) from the parastatal Gambia Produce Marketing Board than had private traders; had been borrowing money from the parastatal Gambia Commercial and Development Bank at lower interest rates than had private traders; and, most important, had been incurring operating deficits that were subsidized by the Government. By eliminating the preferential allowances and favorable interest rates, and by ending government subsidy support, the policy reforms were designed to encourage fair and equitable competition between the public and private sectors.

The evaluation took place in 1989, only 2 years after the financial and agricultural marketing reform program had been launched. During these 2 years a number of institutional rigidities and other problems inhibited the impact of the reform program:

-- Sectoral reforms changed the "rules of the game," a necessary but not normally sufficient change; sectoral reforms usually require a substantial amount of technical assistance and institutional development. Both were inadequate in this case.

-- Donor coordination, although critical to success, was not well executed. Often well-meaning efforts by one donor undercut the work of another donor.

-- Markets are often interlinked; reforms in one market may fail if reforms are not implemented in a linked market. In The Gambia, for example, groundnut marketing was liberalized but the government continued to utilize the Gambia Cooperative Union to handle the sale of donor fertilizer grants. This practice undermined the impact of the policy reforms in groundnut marketing.

-- Reforms in developing country markets are difficult to implement when markets have few buyers and sellers and thus lack effective competition. In The Gambia interest rates in the lynch-pin Treasury bill (T-bill) market were, by some standards, excessive. Efforts by the Office of the A.I.D. Representative in Banjul (OAR/Banjul) to rely on this T-bill rate as a base rate (rates to final borrowers were supposed to be at least 3 to 5 points above the T-bill rate) were probably ill-advised.

-- Government organizations and parastatals live with and understand political and bureaucratic forces, but they may have little understanding or recognition of the benefits of market forces. In the case of The Gambia the acceptance and implementation of competitive market reforms by the Gambian Cooperative Union and the Gambian Commercial and Development Bank were very slow and difficult.

MAP

1. BACKGROUND[1]

1.1 Introduction

In 1987, the U.S. Agency for International Development (A.I.D.) obligated $6 million for The Gambia Economic Policy Reform Program (GEPRP), a program that was intended to work within a comprehensive multidonor economic reform program. At the time of this evaluation $4 million had been disbursed and the remaining $2 million was to be disbursed in 1990. The GEPRP was designed to create a policy and institutional environment that would encourage greater market efficiency and competitiveness, and greater access to markets, for private entrepreneurs particularly in the finance and groundnut marketing sectors. The purpose of this evaluation was to identify the impacts of this sectoral policy reform program on the economy as a whole, and, especially, on the institutional and sectoral levels.

[1]Additional information, data and analysis, as well as a discussion of evaluation procedures, are available in A.I.D./Center for Development Information and Evaluation (CDIE) Working Paper No. 133, which can be obtained from the A.I.D. Library.

The three-person evaluation team visited The Gambia in September/October 1989 to assess the impacts of the GEPRP. The team's methodology included a rapid rural appraisal. The evaluation team conducted extensive interviews with officials of The Government of The Gambia, international organizations, and focus groups involving farmers and representatives of the private sector. The evaluation team also relied on evaluations and background studies provided by the World Bank, the International Monetary Fund (IMF), the International Food Policy Research Institute, and Cornell University, as well as on discussions with the Harvard Institute for International Development--an organization that played a key role in the development of the GEPRP.

1.2 Country Setting

The Gambia is the smallest country in continental Africa. It forms a narrow enclave (16 to 30 miles in width) within Senegal, bordering on the Atlantic Ocean and extending inland 350 miles east on both banks of The Gambia River (see map). It has a small population of about 850,000, a low per capita annual income of about $240, and a limited domestic market.

About 70 percent of the population lives in rural areas, with most people engaged in farming. Virtually all agriculture is rain-fed. Farmers grow rice; coarse grains such as maize, millet, and sorghum; groundnuts (peanuts); and a little cotton. The latter two are grown principally as cash crops. Groundnuts account for most exports of domestic goods (around 85 percent in recent years), with other agricultural or agro-industrial products comprising the remainder. Entrepot trade (i.e., the transhipment or reexport of imported goods to other countries of West Africa) and the tourist industry are also foreign exchange earners. Processing and trade in groundnuts accounts for a small but significant share of the gross domestic product (GDP).

Rapid growth of the public sector during the 1970s attracted migrants to the cities. By 1985 the Banjul, Kombo, St. Mary, and periurban Brikama areas accounted for about 30 percent of the total population, up from 15 percent a decade earlier. The best current estimates suggest that average rural per capita income ranges from 26 to 45 percent of average urban per capita income and is about 70 percent of per capita income in such semiurban areas as Farafenni and Kaur.

Life expectancy in The Gambia is 43 years, among the lowest in the world. Infant and child mortality rates are very high; only an estimated one out of three infants born in The Gambia survives to age 5 years. Literacy rates are very low. The incidence of chronic diseases and seasonal malnutrition is severe, and maternal mortality rates are extremely high (see Table 1 for comparative socioeconomic data).

Economically, The Gambia is heavily dependent on trade. During the 1970s, entrepot trade expanded rapidly, largely because neighboring countries increasingly resorted to high tariffs and quotas to protect their domestic industries. The duties paid in The Gambia on imports that are subsequently reexported (or smuggled to other countries) constitute an important source of government revenue. These exports normally are sold for fully convertible foreign exchange.

1.3 Macroeconomic Context

The Gambian economy began unravelling in the mid-1970s for two main reasons. The first was a severe decline in the country’s terms of trade. Because of a softening in world prices for groundnuts and an increase in the world price for oil in 1982-1983, the terms of trade index for The Gambia fell to one-third the level in 1976-1977. (The terms of trade improved in 1983-1984 only to fall in 1985-1986, and have moved erratically ever since.) Trade deficits were substantial after 1979, and foreign borrowings steadily increased. The second reason was the weakening management of the public sector. During the late 1970s conditions steadily deteriorated, and, by 1979, the public sector was experiencing a significant and growing budget deficit. Public sector expenditure and employment grew rapidly, contributing to large increases in imports.

Between 1976 and 1985, per capita income, adjusted for inflation, fell by one-fourth. A large and chronic fiscal deficit, along with a massive and unsustainable trade deficit, eventually created a major crisis in 1985--a crisis that was evident to all. Consumers were not able to buy rice and other basic foods. Fuel, medicine, and other essential imports were not available at any price. Foreign exchange commanded a 50-percent premium on the parallel market and inflation accelerated. Business confidence was shattered, private investment dropped to nearly zero, and capital flight increased significantly. By mid-1985, external public debt was twice the level of aggregate GDP, and The Gambia was $75 million in arrears to the IMF and other international creditors.

In June 1985, the Minister of Finance and Trade assembled a task force to develop a comprehensive, far-reaching economic recovery program. The program established six basic objectives:

-- Stimulate agricultural production.

-- Stimulate output and employment in other productive subsectors (e.g., fishing, manufacturing, tourism).

-- Reform the foreign exchange system.

-- Reform the public sector, including parastatals.

-- Improve monetary and fiscal policies and reform the financial subsector.

-- Increase the productivity of public investment.

Implementation of the Economic Recovery Program began at the end of June 1985. The Government devalued the national currency and then allowed the exchange rate to float; it created a flexible Treasury bill (T-bill) market in order to develop a free market interest rate; it instituted reforms in the customs and revenue departments and initiated reforms in parastatal enterprises, particularly in those involved in rice and groundnut marketing and in financial markets.

The policy reforms implemented under the Economic Recovery Program were designed in part to place the public and private sectors on an equal footing in order to stimulate a more competitive and efficient market environment. Two major institutions--the nominally independent Gambian Cooperative Union and the parastatal Gambian Commercial and Development Bank--had impeded the achievement of an open, competitive environment in the important areas of finance and groundnut marketing. (The Gambian Commercial and Development Bank was essentially bankrupt because of bad management.) Prior to the 1987-1988 groundnut buying season, the Gambian Cooperative Union enjoyed preferential access to credit from the Gambian Commercial and Development Bank at less than market interest rates. Also the cooperative had monopolistic control over key agricultural inputs.

2. DESCRIPTION OF THE A.I.D. POLICY REFORM PROGRAM

The 1987 A.I.D.-funded Gambia Economic Policy Reform Program (GEPRP) was designed to support the overall Economic Recovery Program by helping to create, at the sectoral level, a policy and institutional environment that would encourage and promote greater access to markets for private entrepreneurs. The GEPRP emphasized reforms in the finance and groundnut marketing sectors. The program was designed to eliminate subsidies and other inequities and to expose the Gambian Cooperative Union and the Gambian Commercial and Development Bank to competitive market forces. A.I.D. policy conditionality included the following elements:

<u>Financial market reform</u>. There was to be no preferential access to credit. All borrowings from official sources were to "be at not less than market-determined interest rates." The move to market-determined interest rates and to nonpreferential access to credit was intended to place the private and public sector on an equal footing and to lead to increased competition and efficiency.

What constitutes a "market rate of interest" is not precisely clear. As interpreted by the Office of the A.I.D. Representative in Banjul (OAR/Banjul), this phrase implied a rate sufficiently above the Gambian T-bill market rate to cover administrative costs and loan risk. As the reforms were implemented, strict adherence to this interpretation became difficult because real interest rates rose and remained disturbingly high. (The fear was that very high rates would choke off investments.)

<u>Groundnut marketing reform</u>. The government was to ensure that the parastatal Gambia Produce Marketing Board paid the same prices to all licensed buyers of groundnuts, both public and

private. This meant the end of the preferential (higher) buyers' allowances granted to the Gambia Cooperative Union. (Buyers' allowances are administratively determined sums intended to cover the marketing margins of private traders and the cooperative.) The reform was intended to encourage competition between the cooperative and private traders and to improve the efficiency of the groundnut buying business. Two months after the GEPRP grant agreement was signed, the Government announced the equalization of groundnut marketing allowances.

The intended impact of the GEPRP financial and groundnut marketing reforms were based on the following assumptions:

Improvements in finance would increase private sector access to credit. Increased private sector access to credit would lead to increases in private business investments in all sectors, particularly in agricultural input and output marketing. Simultaneous policy reforms ending preferential groundnut buyers' allowances would permit competition in these markets, which in turn would yield lower marketing costs (specifically in groundnut buying).

The intended impact of the GEPRP is rather modestly described in project documents. However, for the purposes of this impact evaluation, the evaluation team tried to identify the impact of the GEPRP-supported reforms on specific institutions and sets of individuals. The team assumed, for example, that lower marketing costs would increase the returns to groundnut traders and to farmers. The team tried to identify impacts of the GEPRP on these, and other, groups most likely to be affected by the GEPRP reforms.

3. DEVELOPMENT IMPACT

From a broad macroeconomic perspective, the earlier (1985-1987) multidonor Economic Recovery Program was impressive and its impacts clear--the economy staged a recovery, inflation came down dramatically, the Government sharply reduced its budget deficit, agricultural production increased, exports picked up, and the foreign exchange crisis ended.

In 1986 The Gambia successfully negotiated debt-rescheduling agreements with its official bilateral and commercial creditors and appealed for financial assistance. The response was phenomenal; in FY 1987, The Gambia arranged for $98.5 million in external support, which amounts to more than $120 per person. Over the 1986-1990 period, external support to The Gambia is expected to total nearly $400 million. A.I.D.'s financial assistance to The Gambia has been small, about 4 percent of total donor support. The GEPRP is part of that assistance.

When assessing the impact of the 1987-1989 A.I.D.-supported sectoral reforms, it is important to keep several points in mind: (1) many of the specific reforms specified in the conditions precedent to the GEPRP (e.g., stopping preferential access to credit) had been undertaken by the Government well before the GEPRP was approved, presumably as part of the broader Economic Recovery Program (accordingly, the evaluation team sometimes found it difficult to distinguish impacts properly attributed to the GEPRP from those properly attributed to the Economic Recovery Program); (2) the $6 million GEPRP was relatively small (at the time of this evaluation only $4 million had been disbursed), and the program focused on a limited set of reforms; (3) the World Bank, IMF, and other bilateral donors had large programs designed to have an impact on a broad array of sometimes overlapping economic areas; (4) external factors (e.g., weather, export demand, and prices) had a major economic impact; and (5) GEPRP was designed to change institutional relationships and market behavior, changes that often take many years to achieve fully. In this context, identifying significant, measurable, positive impacts from the GEPRP reforms was difficult.

GEPRP financial sector reforms were affected by the larger macroeconomic environment and the slow pace of institutional change. The macroeconomic need to increase foreign exchange reserves and prevent capital flight meant that domestic interest rates had to be higher than comparable rates in Europe, especially in the United Kingdom.[2] The effect of maintaining high rates of interest was to increase foreign exchange reserves and encourage domestic savings while discouraging investment in all but a few very profitable activities (e.g., tourism, entrepot trade). In such an environment, groundnut or fertilizer marketing were not especially attractive investment opportunities for the private sector. Moreover, sectoral policy and regulatory reforms typically need to be complemented by institutional change. In The Gambia, these reforms were inhibited by the slow pace of institutional change.

Although the impact of the GEPRP has so far not been that impressive, the program is still young, barely 2 years old at the time of this evaluation. The Government now is addressing key institutional constraints, including those involving the Gambia Commercial and Development Bank, and is responding creatively and with flexibility to the lessons learned in implementing a complex program of policy reform and institutional change. For example,

---

[2]High real (adjusted for inflation) interest rates discourage capital outflows and stimulate capital inflows.

there is considerable evidence of change in both the Gambia Cooperative Union and the Gambia Commercial and Development Bank. An evaluation of the GEPRP 2 years from now will likely identify considerably greater impact at the institutional level than has been identified in this evaluation.

3.1 Economic Impact

3.1.1 Finance

In general, the Government's commitment to market-determined interest rates encouraged savings significantly and increased the costs of borrowing. Bank loans and deposits grew, but loans grew less rapidly, in part due to the imposition of credit ceilings by the IMF. Between September 1987 and June 1989, demand, time, and savings deposits in the banking system increased by 40 percent, from Dalasi (DD) 188.5 million to DD263.7 million. Between September 1987 and June 1988, commercial bank loans to the private sector were roughly constant, but rose by 15 percent between June 1988 and June 1989; much of this increase was due to growth in tourism. Loans for agricultural marketing moved erratically, perhaps signaling some uncertainty.

The Government adopted policies calling for market-determined interest rates and for the cessation of preferential access to credit. These are substantial achievements. However, as of the time of this evaluation, these policy reforms had not stimulated increases in private sector investment in agricultural input and output marketing.

3.1.2 Groundnut Marketing

Even after equalizing allowances between private traders and the Gambia Cooperative Union, private traders were reluctant to enter the groundnut buying market. The cooperative continued to hold a de facto monopoly in fertilizer distribution because it handled all foreign aid fertilizer donated to The Gambia.[3] Many farmers, unwilling to jeopardize their access to fertilizer, continued to sell most of their groundnuts to the Gambia Cooperative Union.

However, more recently, private traders appear to have become much more active than in the past. In 1988-1989 the

[3]The Government made no attempt to auction that fertilizer to private traders, which effectively kept private traders from experimenting with fertilizer marketing. Private traders have not handled fertilizer marketing in more than 20 years.

amount of groundnuts handled by the Gambia Cooperative Union fell to its lowest level in years. Much of the crop was sold (often smuggled) by private traders to Senegal, since the Senegalese price was higher. This fact suggests that in at least some aspects (e.g., those related to the transport of groundnuts to Senegal), the lack of formal sector credit may not be the binding constraint to the groundnut marketing business. The evaluation team speculates that in 1988-1989, the Gambian and Senegalese informal financial markets provided much of the capital needed to deliver groundnuts into Senegal. However, the role of the informal financial markets in The Gambia is not well understood.

Despite the equalization of groundnut marketing allowances, private traders did not capture a greater portion of The Gambia’s domestic groundnut market. There were two main reasons. First, those allowances, although equal, were (administratively) set too low; while the cooperative simply went further into debt, those few private traders who did test the waters were badly squeezed. Second, private traders had to pay their loans on time and finance their operations from their own funds, whereas the cooperative did not have to do either. The cooperative was allowed to accumulate a large debt at the Gambia Commercial and Development Bank without servicing that debt in a timely manner. The Gambia Cooperative Union was confident that it would be rescued by government funds.

In broad terms, therefore, equalization of allowances had virtually no impact on the groundnut marketing sector, in large part because the Gambia Cooperative Union was able to accumulate, rather than actually pay, its debt. However, the Government's professed interest in equalizing allowances sent a strong signal to traders that it was interested in reforming the groundnut trade. Given sufficient commitment to that goal, the equalization of allowances may one day be seen as the first step in a long process of market reform.

3.2 Institutional Impact

3.2.1 Finance

Responding to political rather than commercial appeals, the Gambia Commercial and Development Bank often financed unprofitable investments. Its loan portfolio was too heavily concentrated among too few borrowers, notably the Gambia Cooperative Union. The Bank's equity base was far too small, management was woefully deficient, and the bank has been essentially bankrupt for years.

Until recently, bank management had not heeded calls for institutional reform. In October 1988, under considerable pressure, the board relieved the top four managers of the bank of their duties and appointed a new acting managing director. The Government implemented a number of measures designed to improve the bank's financial position; one such measure was the Government's acceptance of responsibility for about DD50 million in liabilities incurred by the Gambia Cooperative Union.

These and other institutional reforms are beginning to take hold. The bank now has some liquidity; in September 1989 it entered the T-bill market for the first time. A stronger bank, operating efficiently along commercial lines, could make a significant contribution toward achieving the objectives of the GEPRP.

3.2.2 Groundnut Marketing

At the time of this evaluation, the Gambia Cooperative Union continued to hold institutional advantages over its private rivals. For example, it still had access to no-cost funds from the World Bank's Agricultural Development II project. It also had received, at no cost, donor-supplied trucks and, as noted above, it maintained a virtual de facto monopoly in fertilizer distribution. A private trader cannot compete and stay in business in this type of marketplace.

The groundnut marketing costs of the Gambia Cooperative Union are substantially higher than those of private traders. However, these high costs are partially--perhaps fully--offset by the implicit subsidies the cooperative continues to receive (through, for example, cheap donor credit lines). Furthermore, farmers whose livelihood is dependent on their access to fertilizer, subsidized or not, are understandably reluctant to sever their ties with the cooperative. Also there appears to be a political dimension to the Gambia Cooperative Union; it is the only nationwide organization based in the capital that has substantial links to rural areas.

As stated earlier, equalization of allowances for the 1987/1988 and 1988/1989 buying seasons did not stimulate greater competition in groundnut marketing, for the reasons already noted. Recognizing this, the Government took an additional step in the reform process. It announced that it would eliminate the allowance altogether for the 1989/1990 buying season. The management of the Gambia Cooperative Union believes that as a result of this policy decision, it will have to operate more efficiently. Management is cutting excess staff, eliminating (through consolidation) member societies that are too small to be financially viable, and establishing strict cost controls over the use of its fleet of vehicles. Under prospective competitive pressure, it is struggling to overcome the growing sense of disaffection that has lately characterized the relationship between the member farmers and the management of the cooperative. In short, despite the advantages that continue to accrue to the cooperative, the elimination of buying allowances has produced at least a credible threat: the first signs of a competitive environment in groundnut marketing may begin to emerge during the 1989/1990 buying season.

3.3 Social and Distributional Impact

3.3.1 Social Services

In the wake of the Economic Recovery Program, massive donor support (including support provided by A.I.D.) did more than merely protect government-provided social services. The Government actually increased the supply of those services. For example, in 1987 the Government selected seven regional health centers for upgrading; two have been completed. In the same year the Government expanded maternal and child health services, the national immunization campaign, and nutrition programs targeted to the most vulnerable groups. The evaluation team found little evidence of any impact of the GEPRP on social services in the Gambia. The team believes, however, that the successful (macroeconomic) Economic Recovery Program stimulated the expansion of social services for the poor. Accordingly, the experience of The Gambia provides an interesting perspective on the debate concerning the deterioration of government-supported social service programs for the poor in the context of a major economic reform program.

3.3.2 Finance

In The Gambia inflation fell from a peak annual rate of about 70 percent in 1985-1986 to about 8 percent in the third quarter of 1989. Real interest rates became positive for the first time in 1987-1988. The real T-bill interest rate in the third quarter of 1989 was about 10 percent. The current rather high real interest rates mainly affect the large well-established firms located primarily in urban areas, where the majority of borrowing and saving involving formal sector financial institutions takes place. High real interest rates appear to have also affected the urban-based demand for credit by smaller firms and by others with access to institutional credit sources.

Without further study, it is not possible to know the effect of the rapid upward movement in real interest rates on informal financial markets. Nor is it possible to speculate meaningfully on the impact of the high rates on women, who satisfy the bulk of their credit demands through the informal markets.

Prior to the policy reforms in the formal financial markets, farmers who were able to gain access to credit received an implicit credit subsidy measured by the gap between the low rate of interest actually paid and the hypothetical market-clearing rate. However, there is no evidence that farmers generated excess demand for formal sector credit. Credit and other (e.g., fertilizer) subsidies provided through the Gambia Cooperative Union appeared to be more or less offset by the excessive costs, borne by the farmer, of doing business with the cooperative. For example, a farmer might receive cheap credit and subsidized fertilizer, but he also receives his fertilizer late in the season and often in inadequate amounts thus reducing his potential crop yield; he also receives a less than adequate price for his crop thus reducing his overall income.

What little evidence there is suggests that, on balance, the costs to farmers of working through the cooperative exceeded the benefits provided: poorer farmers tended to rely more heavily on the cooperative than did richer farmers who presumably had sufficient assets to enable them to exploit the few and limited alternatives to the cooperative that might exist.

Recently some members of the Gambia Cooperative Union found themselves unable to pay high interest charges and were therefore cut adrift by the cooperative (others were cut off because they did not repay previous loans). These farmers appear to have been among the most adversely affected by the rise in real interest rates. They were typically poorer farmers, without recourse to other alternatives. It appears that lack of access to alternative sources of credit and inputs rather than high interest rates per se has been and continues to be the major constraint facing the poorer farmer.

3.3.3 Groundnut Marketing

As noted above, the equalization of purchase allowances introduced in the 1987/1988 groundnut buying season did not increase the farmers’ options for marketing groundnuts because the private traders did not enter the market. The complete elimination of allowances in 1989/1990 may well help stimulate the entry of private traders into the market and may prove to be a significant step toward increased competition in the groundnut marketing business.

In interviews with farmers and small traders, the evaluation team found evidence to suggest that some individuals might compete in groundnut marketing with the Gambia Cooperative Union. Some small traders were rebuilding their relations with prospective clients. Others expressed interest in leasing transport equipment. A few richer farmers expressed interest in the requirements (such as minimum amounts deliverable to the depots) that would be imposed on farmers who wanted to transport their own produce. Some expressed concern at having to combine their loads with those of their neighbors. Larger traders did not seem interested in reentering the trade. Their reservations about reentering the groundnut marketing business centered on the high capital costs involved.

4. FACTORS INFLUENCING THE PERFORMANCE AND IMPACT OF THE GEPRP

4.1 Government Commitment

A.I.D.'s GEPRP was part of (and, in strictly financial terms, helped support) The Gambia's highly successful macroeconomic recovery program. Although the macroeconomic recovery program was successful, the GEPRP sectoral reforms, as of the time of this evaluation, have at best had only a limited impact on the financial and groundnut marketing sectors. However, the Government continues to press for specific changes, which, if well implemented, will enhance the impact of the GEPRP reforms.

For example, the Government found it difficult to effect the necessary institutional reforms in the Gambia Commercial and Development Bank. The problems remain serious. In 1988, non-performing loans accounted for about one-quarter of the bank's portfolio. Over 40 percent of these were loans to the Gambia Cooperative Union, which held a powerful position on the bank's board. Persistence, however, appears to be overcoming institutional inertia. OAR/Banjul is negotiating the terms of a proposed technical assistance contract that would provide three long-term expatriate banking experts to work in tandem with a World Bank funded long-term expatriate managing director. This team of expatriates would train Gambian staff, reorganize the bank, and make its operations more efficient. In time, the bank may become a viable commercial financial entity.

A second example of the importance of the Government's commitment can be found in the groundnut marketing area. Recognizing that the equalization of groundnut marketing allowances had failed, the Government abolished the allowances altogether. Starting with the 1989/1990 buying season, the Gambia Produce Marketing Board will announce a depot purchase price rather than a producer price. Anyone--for example, farmer, private trader, the Gambia Cooperative Union representative--able to meet a 5-metric ton minimum lifting requirement can transport groundnuts to one of the board's 10 depots. This new system appears to have stimulated a more competitive environment; only time will tell if truly competitive market conditions will emerge and prevail.

4.2 Donor Coordination at the Policy Level

Coordination among donors, especially among A.I.D., the World Bank, and the IMF at the macroeconomic level, was outstanding during the design phase of the GEPRP. But macroeconomic policy reform is attained through a process, a dialogue. The program is not designed and implemented as though it were an immutable written contract. In The Gambia, a number of reforms, including those involving interest rate structures, are negotiated in the context of annual IMF/World Bank programs, negotiations to which OAR/Banjul is not invited. As a result, A.I.D. is not a player when key policy issues on interest rate reforms are discussed. There are differences between A.I.D. on the one hand and the IMF and the World Bank on the other; A.I.D.'s documents refer to market-determined rates of interest while the IMF/World Bank documents refer to "flexible" interest rates. Mechanisms for resolving the resulting donor differences have been inadequate.

In one instance, the Central Bank of The Gambia issued a key policy document on agricultural credit. Citing consistency with the IMF/World Bank agreements, that document sanctioned the disbursement of agricultural credit through the Gambia Cooperative Union at rates below the prevailing T-bill rate, that is, at rates well below those paid by private traders who might wish to compete with that cooperative. This policy announcement was inconsistent with the interpretation of "market determined rates of interest" adopted, at that time, by OAR/Banjul.

4.3 Donor Coordination at the Project Level

Donors are often the primary cause of or instrument for "backsliding" on the part of recipient governments. On several occasions, OAR/Banjul questioned the Government of The Gambia in connection with policy decisions that appeared to violate the principle of market-determined rates of interest. For example, in 1988 the African Development Bank developed and subsequently implemented a project that conformed to its self-described policy of providing subsidized credit to farmers. In 1989, the International Fund for Agricultural Development proposed a small-scale water control program that contained a provision for below market interest rates for agricultural credit. Made effective in April 1989, the World Bank's Enterprise Development project made funds available to commercial banks at 3 percentage points below the prevailing T-bill rate. All of these donor projects provided funds at interest rates that violated the terms of the GEPRP policy reforms as then interpreted by OAR/Banjul. Indeed, that interpretation probably was too narrow.

4.4 Technical Assistance

The GEPRP was designed with a $850,000 complementary technical assistance grant program. The technical assistance was designed, inter alia, to help the Government develop policy options in term lending and agricultural credit and development lending, and to help monitor the Government's performance in the reform program. These areas normally require substantial technical expertise. However, as a result of delays and difficulties encountered in finalizing a contract for the complementary technical assistance for the GEPRP, OAR/Banjul was forced to rely on technical assistance already being provided to the Government through another project to assist in policy development and GEPRP performance monitoring. In addition, OAR/Banjul used its staff to help manage the GEPRP and work with the Government to ensure timely implementation of the GEPRP. At the time of this evaluation, the only technical assistance financed under the complementary technical assistance program grant was the baseline data survey of April 1988, which generated the benchmarks and indicators used by OAR/Banjul and the Government to measure program impact.

4.5 External Factors

Several external factors have improved the economic climate and helped the reform process:

-- Good weather, which helped increase agricultural production

-- A halt in the secular deterioration of the terms of trade

-- A strong prorural political bias in the early years of the Economic Recovery Program combined with a relatively quiet urban-based political opposition, the latter despite sharp cut-backs in public sector employment and high inflation rates, both of which disportionately affected urban dwellers

-- Satisfactory relations with neighboring Senegal

5. LESSONS LEARNED

1. Host country government support is critical. No policy reform package is likely to be successfully implemented unless it is solidly supported by key elements in the Government. In The Gambia, government support was very strong in some areas (e.g., equalizing and subsequently eliminating groundnut purchasing allowances) and less strong in others (e.g., changing the roles

of institutions such as the Gambia Cooperative Union). Government support typically rests on an analysis, formal or otherwise, of the impact the reforms are likely to have on institutions and individuals. This "political economy" aspect of policy reform is of primary importance to the host country government and should be of equal importance to A.I.D. Designers of conditionality provisions cannot be expected to foresee with clairvoyance that the reforms they design are fully sufficient for achieving development impact. However, they do need to better understand, if still imperfectly, the likely impact of these reforms on institutions and individuals. A.I.D. needs to incorporate into all of its policy reform projects and programs monitoring and impact assessment systems that are based on a good understanding of the relevant issues of political economy.

2. Donor coordination is critical. If the GEPRP is any guide, donors coordinate effectively in the design stages of a major policy initiative. The problems come later, when the implementation of that initiative comes into conflict with other donor projects and programs operating in that same, or in a closely related, area. Existing formal policy dialogue procedures that operate during the formulation of the annual World Bank/IMF policy documents may not work very well, essentially because of the weak role of bilateral donors in those processes.

3. <u>In general, the effects of a complex policy reform program do not emerge quickly</u>. To be sure, some policies can be decreed "with the stroke of a pen." Some institutions may also be established or reformed within a relatively short period. However, 2 years is simply not enough time to allow the impact of reforms such as those undertaken in connection with the GEPRP to emerge.

4. <u>In general, policy reforms should be accompanied by structural reforms at the institutional level</u>. Implementing the policy and regulatory changes associated with the GEPRP did not have a significant impact on the financial or groundnut marketing sectors, except that doing so continued the process and pace of reform. The institutional inertia of the Gambia Commercial and Development Bank and the efforts of the Gambia Cooperative Union to continue to play by the old rules limited the impact of the policy reforms.

5. <u>Implementing broad policy reforms is difficult and requires substantial amounts of technical assistance</u>. Policy reform is a process that requires constant monitoring and adjustment as the effects of each new policy emerge. Many governments lack sufficient knowledgeable analysts to study and suggest policy adjustments during a reform process. The declaration by the Government of The Gambia that henceforth

market-determined interest rates will prevail was simply inadequate. The precise operational meaning of that phrase was unclear. A.I.D.'s failure to provide technical assistance to help the Government operationalize a market-determined interest rate policy and to develop suitable policy options added to the problem.

6. A change in policy alone does not necessarily translate into the desired impact at the institutional--or individual--level. Institutional transformation was not incorporated explicitly into the design of the GEPRP. However, institutional change frequently is essential to the success of a policy reform program. Because of institutional rigidities, policy pronouncements by themselves are usually not enough to change the structure and functions of institutions and affect the behavior of individuals in those institutions. Institutional change usually is difficult and typically requires substantial amounts of technical assistance.

7. Policy reform programs usually require intensive donor and recipient staff support. Because policy reform programs need technical assistance to help make policy reforms operational and to accelerate necessary institutional changes, they are intensive users of highly skilled professionals.

8. Project designers must be especially sensitive to the phenomenon of interlinked markets. In The Gambia, one important reason why domestic interest rates are maintained at a high level is because the domestic and international financial markets are closely linked: High domestic interest rates stimulate capital inflows and inhibit capital flight. One important reason why the Gambia Cooperative Union is able to retain its market share of the groundnut marketing business is because the agricultural output and input markets are closely linked: Farmers are inhibited from dealing with private traders (rivals to the cooperative) out of fear that the cooperative (given its virtual monopoly power) will deny them access to fertilizer.

9. The A.I.D. policy prohibiting assistance to or through a parastatal, unless there is an agreement to privatize that parastatal, hinders the institutional reform process. In The Gambia, during the GEPRP design, OAR/Banjul recognized the need for institutional reform at the Gambia Commercial and Development Bank and the Gambia Cooperative Union. But, given A.I.D.'s policies and lacking a commitment from the Government of The Gambia to privatize either entity in 1987, OAR/Banjul was forced to focus on changing the policy and regulatory environment in which these entities operated. Both organizations, after displaying considerable institutional inertia, recently initiated substantive reform programs. In the absence of the restrictive

A.I.D. policy, OAR/Banjul could have provided the parastatals with training and technical assistance in 1987 in order to work for the necessary institutional changes from within.

10. OAR/Banjul’s definition of market-determined interest rates may be overly rigid, particularly when markets are small and noncompetitive. As part of the GEPRP, OAR/Banjul argued forcefully, with the Government of The Gambia and with other donors, that interest rates charged to financial intermediaries should be, at a minimum, at T-bill rates. Interest rates charged final borrowers should be higher to cover administrative costs and risk. In The Gambia the T-bill market is thin and closely managed; the number of participants is few and the minimum size requirements are high. As The Gambia’s rate of inflation fell, nominal rates were kept high. Real interest rates rose to very high levels. While the economy has been growing, the evaluation team is concerned that, if excessive, high real rates may inhibit investment and choke-off economic growth.

11. Policy reform programs should be implemented flexibly, acknowledging the dynamic context in which they operate. Circumstances change, whether because of a realignment of political forces, deteriorating relations with neighboring countries, an improved understanding of the way markets operate, or any of a host of other factors.

PROGRAM DATA SHEET

1. Country: The Gambia

2. Program Title: The Gambia Economic Policy Reform Program (GEPRP)

3. Program Numbers:

   a. Program Grant: 635-0228
   b. Complementary Program Grant (Technical Assistance): 635-0231

4. Program Authorization:

   a. Program Grant: 1987-1990 (ongoing)
   b. Complementary Program Grant: 1987-1990; amended 23 January 1989

5. Program Completion Date: December 31, 1990

6. Program Funding:

   a. A.I.D. Total:
      -- Program Grant: $6 million
      -- Complementary Program Grant: $850,000
      -- Other Donor: none
      -- Host Country: none

7. Mode of Implementation: Program Grant Agreement and Complementary Program Grant Agreement between A.I.D. and the Government of The Gambia, Ministry of Finance and Trade, Implemented by the Ministry of Finance and Trade.

8. Evaluation: Special joint evaluation of program in 1989, accepted by the Office of the A.I.D. Representative/Banjul as meeting the mid-term evaluation reporting requirement.

9. Responsible Officials of the Office of the A.I.D. Representative/Banjul during life of program to date:

   a. A.I.D. Representative: Jimmie M. Stone
   b. Program/Project Officer: Thomas J. Herlehy, Fred Witthans

10. Host Country Exchange Rates:

   a. Name of Currency: Dalasi (DD)

b. Exchange rate (floating):
- -- Quarter Ending December 1987: DD6.44 = $1.00
- -- Quarter Ending December 1988: DD6.66 = $1.00
- -- Quarter Ending June 1989: DD7.74 = $1.00

Table 1. Selected Economic and Social Indicators

Country	GNP Per Capita 1986 (dollars)	Average Annual, Per Capita GNP Growth Rate 1965-1986 (percent)	Average Annual Rate of Inflation (percent)		Life Expectancy at Birth 1986 (years)
			1965-1980	1980-1986	
Gambia, The	230	0.7	8.3	10.9	[illegible]
Guinea-Bissau	170	-2.0	-	32.9	[illegible]
Senegal	420	-0.6	6.5	9.5	[illegible]
Sierra Leone	310	0.2	8.0	33.5	[illegible]
Mali	180	1.1	-	7.4	[illegible]
Mauritania	420	-0.3	7.7	9.9	[illegible]
Sub-Saharan Africa	370	0.9	12.5	16.1	[illegible]

Note: GNP is gross national product; ODA is Official Development Assistance and na is not available

Sources: World Bank, World Development Report 1988, Oxford University Press, New York, June 1988. Organization for Economic Co-operation and Development, Development Co-operation in the 1990's, OECP, Paris, 1989.

Additional information, data, and analysis, as well as a discussion of evaluation procedures, are available in A.I.D./Center for Development Information and Evaluation (CDIE) Working Paper No. 133, which can be obtained from the A.I.D. Library.

High real (adjusted for inflation) interest rates discourage capital outflows and stimulate capital inflows.
The Government made no attempt to auction that fertilizer to private traders, which effectively kept private traders from experimenting with fertilizer marketing. Private traders have not handled fertilizer marketing in more than 20 years.