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NON-PROJECT FINANCING AND COMPLIANCE MONITORING WITH EMPHASIS ON AGRICULTURE

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By: OSWALD BLAICH

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Prime Contractor: **Abt Associates Inc.**, 55 Wheeler Street, Cambridge, Massachusetts 02138 • (617) 492-7100

Subcontractors: **Robert R. Nathan Associates, Inc.**, 1301 Pennsylvania Avenue, N.W., Washington, D.C. 20004 • (202) 393-2700

Abel, Dait & Earley, 1339 Wisconsin Avenue, N.W., Washington, D.C. 20007 • (202) 342-7620

Oklahoma State University, Department of Agricultural Economics, Stillwater, Oklahoma 74078 • (405) 624-6157

**Non-project Financing and
Compliance Monitoring
with Emphasis on Agriculture**

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September 30, 1988

Oswald Blaich

**Robert R. Nathan Associates, Inc.
Economic and Management Consultants
Washington, D.C.**

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5. Author(s)

1. Oswald Blaich

2.

3.

6. Contributing Organization(s)

Abt Associates, In., Cambridge, MA
 Robert R. Nathan Associates, Inc., Washington, D.C.
 Abel, Daft and Earley, Inc., Alexandria, VA
 Oklahoma State University, Dept. of Agri. Economics, Stillwater, OK

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This paper discusses the process of selecting performance indicators and the extent to which they provide evidence of performance of USAID non-project assistance to developing countries. The analysis is based on the USAID non-project agreements signed with Niger, Mali, Mauritania, Bangladesh, and the Philippines, and on the World Bank structural adjustment loan to Nepal.

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Abstract

A renewed interest in utilizing the leverage inherent in non-project assistance to developing countries to obtain policy and institutional reform has brought concerns among donors and receiving governments about establishing evidence of performance regarding the commitments undertaken. This paper deals with the process of selecting performance indicators and the extent to which they provide evidence of performance. The thesis is based on experiences with recent USAID non-project agreements signed with Niger, Mali, Mauritania, Bangladesh, and the Philippines, and with a World Bank structural adjustment loan to Nepal.

PREFACE

This paper was developed by Dr. Oswald P. Blaich, Principal Associate of Robert R. Nathan Associates, Inc. under the auspices of the Agricultural Policy Analysis Project of the U.S. Agency for International Development (A.I.D.). The firm is a subcontractor to Abt Associates, Inc. under A.I.D. Contract No. DAN-4084-C-00-3087-00.

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NON-PROJECT FINANCING AND COMPLIANCE MONITORING WITH EMPHASIS ON AGRICULTURE

Introduction

In spite of substantial economic assistance from the United States and other donors for more than 20 years, it became apparent in the early 1980s that the policies of many developing countries failed to provide the necessary stimulus to get the most out of their agricultural resources. In recognition of these widespread failures, A.I.D. launched a concerted effort to establish a dialogue with the governments of developing nations on the need to change their policies and the institutions that implement them to be more supportive of agriculture than they had been for more than a decade. It soon became apparent that many governments, although willing, found it difficult to make the policy and program changes needed because such changes invariably required substantial resources and involved significant reductions in benefits to consumers, who held the political balance of power. Clearly, some form of leverage was needed to help overcome the inertia and the cost.

Project assistance, which dominated much of A.I.D.'s development efforts, was not a good vehicle for providing the incentives or the leverage needed for governments to overcome resistance. Projects generally contained their own incentives and compensation and could provide little, if any, leverage for policy reform without jeopardizing the objectives of the project itself. Some other vehicle was needed. The one most seriously considered was a return to the broader form of program assistance that had been an important part of A.I.D.'s total assistance package through much of the 1950s and 1960s. But since this need came at a time when A.I.D. budgets were being reduced, program assistance had to be reinstated as project assistance was phased down.

From these circumstances emerged renewed interest in program assistance with the added emphasis that such assistance be conditioned on agreed-upon policy changes being made. This conditionality brought a new dimension to the policy dialogue. It provided the necessary leverage, but if that leverage was to be exercised effectively, progress toward the reforms would have to be monitored with sufficient reliability to provide acceptable and convincing evidence of performance.

Niger was among the first of the countries selected by A.I.D. to receive a sector grant in exchange for a commitment by the government to undertake specified policy and institutional reforms aimed at easing some of the more important constraints on agricultural production. In addition, the agreement specified that progress toward the reforms was to be monitored in a meaningful way. This became the focus of a special monitoring advisory team.¹

During the same time frame, PL 480 commodity agreements underwent a similar transition. It had been customary for many years to require that certain "self-help" conditions be met as part of the agreement; however, these requirements were usually broad in coverage and lacked specificity. As such monitoring for performance tended to be elusive. In recognition of the need for agricultural policy change, during the dialogues of the early 1980s, these agreements began to include policy and institutional reforms as important self-help requirements. The seriousness of the issues heightened an awareness of the need to establish more rigorous proof of performance. But the nature of that proof, the selection of meaningful criteria, raised new issues in an environment where data were poor and analytical capacity minimal.

The notion of program assistance and even of conditional assistance therefore was not new. What was new, was the emerging seriousness with which the policy reforms were being pursued. Non-project assistance in the

1. Wesley Weidemann and Theodore Cook, *Niger: Agricultural Policy and Credit Reforms*, Agricultural Policy Analysis Project, July 1984.

form of either financing or commodity agreements provided a basis for the leverage needed by the host governments and by A.I.D. to make politically sensitive policy reforms possible. This leverage has manifested itself in the conditionality that the receipt of non-project assistance as well as subsequent tranches of funds or commodities is subject to satisfactory performance in some specified time period.

Since the sector grant to Niger, A.I.D. has provided conditional financing and conditional food aid to many other countries. For example, sector loans have been provided to Bangladesh and the Philippines on condition that certain policies, thought to constrain the achievement of sector goals, be reformed. PL 480 commodity shipments to Mali and Mauritania are examples of such agreements being conditioned on satisfactory performance of the proposed cereals policy reforms.

For the past four to five years, the major multilateral donors have responded to the same set of forces. They have gradually adjusted their development assistance portfolios away from project support and toward non-project financial support with conditions focused on both macro- and microeconomic policy reforms and adjustments in the institutions that implement them. These structural adjustment loans grant the initial and subsequent tranches contingent on evidence of satisfactory performance with respect to the specified structural reforms.

Establishing proof of performance has become one of the more difficult aspects of the implementation of the non-project agreements. Each case ultimately reaches the point of having to agree on the rate of progress that has been achieved with respect to the specified reform. More important, a determination has to be made on whether that progress was sufficient to justify further assistance under the agreement; or perhaps the more difficult is the reciprocal of the same determination: whether the evidence was sufficient to justify withholding further assistance.

To summarize, the establishment of effective conditional non-project agreements must satisfy four interrelated requirements:

- Requirement 1 -- Choosing as conditions of the agreement those policy and institutional reforms that would remove the most important constraints on meeting the targeted development objectives
- Requirement 2 -- Assuring that the specified amount of progress toward meeting those conditions can be met realistically within the specified time frame and in light of the country's financial, economic, and political environment
- Requirement 3 -- Developing a set of indicators that most closely reflect progress in performance for each of the specified reforms and toward the overall objectives
- Requirement 4 -- Utilizing procedures for measuring changes in the performance indicators that are sufficiently accurate to provide acceptable evidence in a negotiation

Failure to satisfy any one of these requirements can reduce or even nullify the leverage inherent in the non-project agreement.² This paper does not, however, address requirements 1 and 2 explicitly. They are mentioned here only because they are extremely important prerequisites to effective monitoring. If these requirements are not met, there is no need to proceed with requirements 3 and 4 because there is no serious purpose to be achieved by doing so.

Satisfying requirements 3 and 4 under an assumption of serious intent is the focus of this paper. To provide a realistic setting, the paper draws on the experiences of A.I.D. in Niger, Bangladesh, the Philippines, Mali, and Mauritania, and of the World Bank in Nepal. It examines the kinds of reforms or structural adjustments that were agreed upon in those cases and looks at the extent to which the evidence of performance reflects progress toward reform. It also addresses the kinds of indicators that would provide the most and the least rigorous evidence of performance.

2. In many situations, the recipient government may be in full agreement with the need for the reforms so that leverage does not need to be exercised by the donor. In such cases, rigorous specification of performance criteria and effective monitoring may not be necessary.

A Survey of Structural Reforms

A survey of some of the foregoing country agreements and other experiences helps to place the different kinds of reforms that have been used as conditions for payment or delivery under non-project agreements into the perspective of requirements 3 and 4. Although each country situation is unique to its environment, there are common threads among them.

Niger, Nepal, Bangladesh, and the Philippines provide cases of conditional financing agreements and the structural reforms that they expected to achieve. Mali and Mauritania are examples of the use of food aid to achieve similar purposes.

Conditionality Associated with Financial Instruments

A wide range of reform requirements has been applied to non-project financial agreements by A.I.D. and other international donors. Most of them have been directed toward achieving changes in sector policies and institutional reform as a means to more effective economic development. But, in many cases, donors realize that macroeconomic policies have had a pervasive influence and that changes in them are often prerequisite to the effective reform of sector policy.

The macroeconomic reforms tend to be associated with discriminatory policies in monetary and fiscal management, income and employment, wages and prices, interest and credit, import and export trade, resource management, and tenure and land ownership. At the sector level, for agriculture and rural development, they tend to address issues in product and input pricing, product and input marketing, privatization and public enterprise management, and institutional reforms related to farm credit, tenure and land use, and rural income and job creation.³

3. For an expanded list of conditions that have been applied by A.I.D. and the World Bank in recent non-project agreements, see Appendix A of this report.

The Government of Niger, for example, agreed in 1984 to take steps toward five reform objectives as a condition for receiving the second and third tranches of an Agricultural Sector Development Grant from A.I.D.⁴ These objectives were to

- Reorient the agricultural input supply subsidy policy and restructure the official input supply agency in order to make more agricultural inputs available to farmers at prices that reflect real economic benefits to the agricultural sector.
- Promote competition in grain marketing through the liberalization of official marketing and pricing policies, and thus reduce the operational losses of the official grain marketing agency, and increase the relative share of agricultural output marketed by cooperatives and private traders.
- Undertake a study of Niger's agricultural credit system, particularly the informal credit market, to formulate appropriate policies to promote the development of effective rural financial markets.
- Promote border trade of livestock, cowpeas, and other agricultural products through the reduction of administrative and fiscal impediments.
- Promote increased cooperative and private trader participation in the supply of agricultural inputs; border trade of livestock, cowpeas, and other agricultural products; and internal grain marketing and storage.

Details of the kinds of performance indicators that were considered as acceptable evidence of accomplishment for each of these reform areas are presented in Appendix A.

The Niger case clearly illustrates that there are several possible performance indicators for each type of reform but that individually none of the indicators provide much assurance that the objectives will be achieved. Yet it is intuitively obvious that some indicate performance in terms of those objectives more clearly than others.

4. *Agricultural Sector Development Grant Agreement between the Republic of Niger and The United States of America, August 31, 1984.* For suggested performance indicators and an analysis of their utility, see Appendix B.

As a condition for a loan in early 1987, the Government of Nepal agreed with the World Bank to continue to make improvements in five policy areas in which the government had already begun to undertake a number of significant adjustments. The first tranche of the loan was made available on the basis of evidence found by a Bank review team that such adjustments were already under way. The second tranche was made available in October 1987 on the basis of further reports, from a supervision mission, and from other observers, that satisfactory progress had been made.⁵

The objectives, targets, and conditions pertaining to the Nepal structural adjustment loan are listed below:⁶

- Macroeconomic Policy -- A major objective of the structural adjustment loan was to promote balanced growth by achieving the following targets with respect to GDP by 1990-91: hold the fiscal deficit to 11 percent of GDP; hold domestic financing to 1.5 percent; increase development spending to 16 percent; raise government revenue to 12 percent; hold regular government spending to about 7 percent; raise government surplus to 5 percent; and raise foreign aid use to 10 percent.
- Development Expenditure Policy -- The commitments to the development program were to increase steadily the level and the quality of investment and operations and maintenance expenditures through improvements in project identification, management, and resource control.
- Industrial and Trade Policy -- A move toward a more liberal policy regime was the primary objective for industry, exports, and imports.
- Agriculture and Forestry Policy -- Because of the overriding importance of agriculture and forestry in the economy, special emphasis was placed on these sectors. Specifically, the emphases were on five intrasectoral areas:

5. Much of the discussion of this case is based on the personal observations of the author while working with the Nepal Ministry of Finance.

6. The details of the conditions, the indicators of performance, and progress toward them as of July 1988 are reported in brief in Appendix C.

- ▶ **Fertilizer:** To increase the supply and timely availability of appropriate fertilizers, to improve economic returns on investment, and to reduce losses
- ▶ **Seeds:** To improve supply and timeliness, especially for major food grains; to improve the efficiency of main institutions in the seed sector; to promote greater private sector participation; and to expand seed production, marketing, and distribution
- ▶ **Food Grain Marketing and Distribution:** To increase food grain production and security throughout the country, to stabilize consumer prices, and to provide producer incentives
- ▶ **Agricultural Research:** To improve the management of the agricultural research activities, to expedite the development and testing of improved technology, and to improve the utilization of manpower
- ▶ **Forestry:** To improve the role of the Panchayats (local governments) in developing, managing, and utilizing local forestry resources
- Public Enterprise Policy -- A significant and special commitment was made to limit the scope of public enterprise activity and improve the efficiency of the remaining ones.

Although this was not specifically an agriculture sector loan, the structural adjustments were nonetheless dominated by that sector, mainly because of its overriding importance in the economy. Appendix B lists not only the specific actions that the Government of Nepal took with respect to each of the objectives but also some measures of end results. These measures provide fairly direct evidence of progress, while other measures, as in the Niger case, are steps in the right direction, but in and of themselves provide little evidence that the ultimate objectives will be achieved to the extent targeted.

The Government of Bangladesh signed an agreement with A.I.D. for funding a Rural Finance Project in three tranches beginning in early 1985. The initial payment was subject to a commitment to undertake a specified set

of policy and institutional reforms of the rural banking system of the country; the second and third tranches were subject to satisfactory performance. The main objective was "to develop a self-sustaining system of rural finance which mobilizes savings and provides adequate credit to farmers and small entrepreneurs."⁷ More specifically, this meant taking the following actions:

- Rationalizing interest rates by imposing ceilings of 12 percent for agricultural loans and 13 percent for industrial loans
- Making efforts to mobilize rural savings through more effective promotional strategies and campaigns, relaxing minimum deposit requirements, and instituting additional advertising
- Improving loan management with emphasis on loan recovery, accounting procedures, lending practices, branch staffing, attitudes toward loan forgiveness, legal procedures, attitudes toward collateral, and the quality of bank inspection

The kinds of indicators that could be used to monitor the foregoing actions are fairly obvious, yet it is also obvious that few, if any of them, would give strong assurance that progress is being made toward the basic objectives. As it turned out, the specified interest rates were found to be too low to achieve their purpose. Thus, in the absence of adequate information about what the "right" rate should be, the specification was changed to allow a more flexible trial-and-error approach. It allowed for

- Setting up an Advisory Committee on Interest Rates
- Establishing a rate of increase (in interest rates) to a level "sufficient" for the development of a self-sustaining banking system

The interest rate issue is a case in which the absence of adequate information about the capital markets and the effects of interest rates would

7. Chris Herman, *Implementing Policy and Institutional Change Via Performance Disbursements: Examples from the Philippines, Bangladesh, and Niger*, PPC/CDIE, U.S. Agency for international Development, July 1985.

almost preclude the rigorous monitoring of progress. It is a case in which the reform actions proposed were merely speculative, as were the results expected. Under these conditions, the flexibility that had to be granted attests to the lack of information and the establishment of the committee as merely a means of passing on the responsibility. Neither action assures that the capital markets will work as intended. While these requirements may not provide much leverage in the short time frame between tranches, they could well be effective in the longer term.

In 1985, the Government of the Philippines was provided with a local resource management loan to help decentralize its development activities to the local level. The focus was on strengthening the capacities of provincial and municipal governments to plan and implement development projects targeted to the local poor.⁸ To achieve these objectives, the government agreed to take the following actions:

- Conduct studies to gain a better understanding of the causes of poverty in the provinces and the specific problems affecting the poor.
- Prepare a provincial development strategy to guide the selection of appropriate subprojects such as small roads and bridges and cattle disbursements.
- Encourage the participation of the private sector in planning and implementation.
- Improve the financial administration of provincial governments and the mobilization of financial resources through better accounting, more accurate forecasts of revenues, improved collection procedures, and an expanded system of property taxation.

As in Bangladesh, this was clearly a case of limited information, which placed the effects that the actions would have on the redistribution of income and employment opportunity in the realm of speculation. It is also a case in which little measurable progress toward the primary objective can be expected

8. *Ibid.*

in the short interval between tranches. Nonetheless, the activities can be construed as a start toward meeting the broader objective of the sector loan.

Conditionality Applied to Food Aid Agreements

There is no inherent reason why the characteristics of reform conditions associated with food aid should differ from those associated with the use of financial instruments. The primary purpose from the donor's point of view (and perhaps that of the host government) is to provide leverage for change. At the same time, it appears natural to associate food pricing and food marketing reforms with food assistance, not because the reforms deal with food, but because food aid has to be distributed through the indigenous marketing system, which is often a very inefficient price-discovery mechanism; and because food aid tends to compete with local food in production and consumption, and so has the potential for disrupting the local market.

An additional and practical difference between commodity and financial assistance lies in the strength of the evidence of adequate performance, should the negotiating process come to a point where the donor has to refuse the next tranche. The likely public reaction to what might be considered sufficient evidence to hold back financial assistance may not be sufficient to hold back shipments of food when hungry people are involved.

Mali and Mauritania provide two examples of the application of policy conditions to assistance provided under Section 206 of PL 480, Title II.⁹ In both countries, the selected reforms relate to grain marketing and pricing policy. The two cases also offer examples of the transition from a long-standing tradition of essentially unenforced self-help conditions to a willingness to use food aid to obtain food system and price policy reforms.

9. Jennifer Bremer *et al.*, *Consolidating Cereals Market Reform in Mali*, Report prepared for USAID/Bamako, July 1986. Donald McClelland, *Evaluation Report: Mauritania PL 480 Title II, Section 206 Program*, A.I.D./PPC/PDPR and Robert R. Nathan Associates Inc., December 1984.

In 1982, the Government of Mali agreed to a multidonor program that aimed to reform the cereal markets.¹⁰ At that time, the cereal markets were dominated by a parastatal organization whose pricing structure and handling restrictions thwarted the efficient operation of the market. The review team that examined the situation reported that, after an enthusiastic start and some early measures of success in liberalizing the coarse grains segment of the market, the effort waned so that by mid-1986 the rice market still had not been liberalized effectively. The team concluded that the current measures were "too weak and diffuse to achieve complete liberalization." The team recommended that under the next agreement, which was then being considered, the monitoring emphasis should be shifted from action-oriented benchmarks to measurable targets that more closely reflected the results that were expected. In this setting the team recommended that the GOM achieve:

- Objective 1, paddy market liberalization, with aims to
 - ▶ Sell 25 percent of the rice milled by the parastatal to private traders with rising targets each year.
 - ▶ Sell 35 percent of the paddy marketed outside of the government organizations to private traders.
 - ▶ Take actions that would bring the farm-gate price within 10 percent of the price in other CFA countries.
 - ▶ Bring the ex-factory price of rice within 10 percent of the import price cif Bamako.
- Objective 2, a flexible market-oriented cereals policy, with aims to bring
 - ▶ Farm-gate prices for maize, millet, and sorghum to within 10 percent of the average price in other CFA countries, no later than four months after harvest.
 - ▶ Consumer prices in Bamako for the same

10. Bremer, *Opcit.*

- commodities to within 10 percent of comparable prices in other CFA countries.
- ▶ Wholesale millet and sorghum prices in Bamako to within 20 percent of the cif price of imports.
- Objective 3, structural adjustment of public marketing institutions, with aims to
 - ▶ Limit commercial paddy milled in government mills to 75 percent.
 - ▶ Cut the parastatal's expenditures by 25 percent.
 - ▶ Complete 90 percent of interregional shipments in private sector trucks.
 - ▶ Hold the parastatal purchase price to no more than 20 percent above the price on the retail market in Sikasso during harvest.
 - ▶ Hold the parastatal selling price to no more than 10 percent below the market price in Bamako four months after harvest.
 - ▶ Hold pre-harvest grain storage levels to no more than 125 percent of the sales during the preceding three months.
 - ▶ Assure that private traders' deliveries to public warehouses in specified regions are at least 50 percent of planned total deliveries for the year.

The proposed indicators were in the form of prices that could be observed in the market with reasonable reliability and for the most part at modest cost. Other indicators, such as the assurance that private traders would be allowed to participate in the market, would likely be obtainable from appropriately maintained records and accounts of the marketing parastatal and the crop estimates that were available.

The Government of Mauritania, after recognizing the ineffectiveness of its long-standing grain policies, agreed in December 1984 to a three-year food grain assistance package that indicated¹¹

- The price of wheat should be raised by UM 2 per kilogram before the release of the next 20,000 metric tons.
- The price of sorghum should be held at the current level.
- A food consumption survey should be conducted to identify the number of people who might be affected adversely by the price increase.
- Radio should be used to report the sales of food grains from the regional centers on a timely basis.

The review team proposed that the next three-year program should require

- Increasing the wholesale price of wheat and sorghum by an agreed-upon amount (a suggested schedule was provided) with each year's food aid shipments being contingent upon this being accomplished.
- Raising the wholesale price of rice to import parity and maintaining an appropriate relationship between rice and other grain prices.
- Conducting a food consumption survey within the next three-year period of the agreement proposed at that time.

It should be noted, however, that the conditionalities lacked the specificity of requirement 3 that would allow measurement and provide negotiating leverage. As in so many countries, this commonly reflects the inadequacy of the data and information base needed to make such determinations. In other circumstances it may reflect an unwillingness on the part of the donor to develop and exercise the leverage that rigorous specification would allow. Thus, while the economic reasoning of the review team and the Mission was undoubtedly flawless, it is likely that in a tough

11. McClelland, *Opcit.*

negotiation it would be difficult to provide hard evidence of effective or ineffective performance.

The Importance of Data

The inclusion of the studies as a condition of non-project agreements reflects the high degree of unease with the specification of the reform conditions and uncertainty over the adequacy of proof of performance. It also raises an important but commonly unanswered question about the value of additional study and planning. In five of the six cases discussed in this report, it was clear that the database was inadequate for part or all of the specified conditions and that willingness to invest additional funds in gathering additional data varied:

- In Niger, the required studies focused on what to do to improve the agricultural credit system.
- In Nepal, the focus was on planning for parastatal divestiture.
- In the Philippines, the focus was on developing a better understanding of the causes of poverty in the provinces.
- In Bangladesh, the uncertainty related to the rationalization of ceilings on interest rates that initially proved to be too low.
- In Mauritania, the concern was the introduction of a food consumption survey.

In the Bangladesh case, a study on interest rates and their behavior in the country's economy might have proven helpful. The social and economic cost of having set the initial interest rate ceilings too low had to be weighed against the cost of the delay involved in getting more detailed advance information that may or may not have provided better guidance. The decision to go without a study may have been a good decision at the time. The course ultimately chosen was to get the needed information through the trial-and-error decisions of a committee.

The foregoing types of information-gathering activities in non-project agreements would obviously have to be included as needed. In general, such studies or related planning activities would focus on information needed to determine the kind of policy reform that will ease the principal obstacles to achievement of the country's and A.I.D.'s development objectives.

The Nature of Conditional Agreements

Any bargain or agreement struck between two parties has costs and benefits for each, and presumably the net benefits in each case outweigh the costs. While discussions of leverage are common within donor circles, recipient governments are also willing to accept conditional assistance. At times, leading policy officials in developing countries may welcome donor support in obtaining politically difficult changes.

In addition to providing resources for development, non-project financing has advantages over project assistance for the recipient in that it provides

- A greater degree of fiscal autonomy and thus more flexibility to allocate donor resources toward its own priorities to achieve a more balanced development program than is usually possible through project funding alone¹¹
- A greater degree of flexibility in dealing with its own internal political system, either to satisfy political pressures or to use the conditionalities as a reason for not yielding to them
- More continuity in financing social and economic development programs than is the case with project-dominated development strategies

11. This is particularly important when many donors are involved in implementing a country's development strategy. It is virtually impossible for donors collectively to produce an efficient development program for a country. A lack of continuity in funding, differences in priorities, and a substantial degree of donor specialization all tend to contribute to a random development strategy, in spite of periodic efforts to coordinate. In countries where only one or two donors are involved, the risk of a random strategy is substantially less.

- An opportunity to operate its development program through its line agencies rather than by superimposed project management structures which proliferate and commonly dominate the development operations of governments

These are important advantages to many developing countries as their institutions mature and they begin to feel increasingly able to assume a greater responsibility for their own destiny. This responsibility also carries with it certain conditions that are essential to more effective development and are an integral part of the maturing process. These conditions include the need for

- A comprehensive program and financial plan for the development of the sector or region which has broad political acceptance
- An institutional capacity to implement the agreed-upon development program according to plan and to monitor the release of funds and personnel as well as the performance of programs and projects in accordance with their objectives
- An appreciation of the constraints on economic development and the will and commitment to deal with them

There is a down side to non-project financing as well, particularly if the preconditions are not fully met. From an economic development point of view, the disadvantages include

- The risk of a slowdown in economic growth if the conditions for planning and implementation are not fully met¹²

12. While the project approach to economic development provides better opportunity for effective management control of all projects, it nonetheless raises a serious question about the total effectiveness of all projects in a development strategy, especially when they are proposed and funded by many donors, each with their own views of what is needed and their own objectives.

In the absence of an effective coordination mechanism under a comprehensive plan, the project approach to economic development invariably leads to less than optimal results even though each project may be cost-

- The possibility that sector financing will not be entirely additional financing of the development effort since it may displace domestic sources of development revenues or allow domestic resources to be diverted to political rather than developmental priorities
- A possible relaxation in host government efforts to finance an increasing portion of the development budget from its own taxes and domestic savings, especially when sector financing provides a large portion of the total funds

From the donors' point of view, the shift to sector financing commonly provides them with an opportunity to

- Achieve policy reforms that may contribute more substantially to people's welfare than is possible through projects and technical assistance only
- Reduce the cost of supervision and direction since more of that responsibility is, in essence, transferred to the receiving country
- Tip the scale for achieving changes that may be politically difficult for the host government to undertake but are important to economic development and are generally not attainable through project operations

There are some disadvantages for donors as well. Even measurable achievements in policy reform or institutional change tend to be more obscure to home constituents than project results, which are commonly visible entities such as roads, buildings, port facilities, and irrigation systems. Even project-related accomplishments such as the numbers of tons of improved seeds distributed, cross-bred cattle raised, or acres of crop fertilized, provide fairly convincing proof of performance. However, policy achievements such as a 5 percent increase in per capita income, a reduction in the consumer price index of four points, or a "strengthened" Ministry of Agriculture. In other words, policy achievements tend to be obscure.

effective. Without proper balance and coordination, a development plan cannot capture the complementarities that are essential to accelerated economic growth.

General Guidance for Selecting and Measuring Performance Indicators

The selection of indicators that provide reliable and convincing evidence of performance is especially important when millions of dollars, thousands of tons of food, or political fortunes are on the line. But, as is invariably the case where information is involved, improving reliability and confidence almost always involves incurring additional costs, which in an impoverished information environment are generally quite high. Thus, the selection of performance indicators requires also consideration of the cost of measurement, which must be justified, at least intuitively, by the effectiveness of that information in contributing to the negotiations.

This section provides some guidance for making that judgment. It discusses some of the major considerations for providing more effective indicators. It does so in the context of the cost and value of information to decision makers in a negotiating environment. This means that the desirable properties of performance indicators should include

- Measures that are correlated to the highest degree possible with the intended end results to be achieved
- Measures that have an acceptable degree of accuracy and reliability

These two qualities are usually obtainable, at some cost, through the application of appropriate accounting, statistical, or econometric procedures. These qualities are important to both the donor and the recipient since "acceptable" evidence or proof of performance, good or bad, is essential to the negotiating process. The extent to which these qualities are not, or cannot, be met acceptably clouds the issues, widens the scope and prospects for unproductive debate, and weakens the leverage inherent in an agreement.

Identifying Performance Indicators

To identify possible indicators of performance, it is important to have

- A clear understanding and definition of the objectives to be obtained by the policy reforms
- A knowledge of the policies and major environmental factors that affect them¹³
- A thorough and detailed understanding of the institutions and institutional interactions involved in implementing the policy reforms

The connection between these three requirements is fairly obvious. It is within this framework that evidence of performance is found.

Figure 1 defines the flow of impact and the possibility set of performance measures; i.e., inputs to a set of activities, outputs from those activities, and the effects that those outputs generate. Together they embrace all of the essential elements of policy reform and the indicators of progress.

The input-output segment of the spectrum is commonly referred to as the implementation process, or the delivery system, which comprises a series of activities designed to produce a given set of outputs. These, and sometimes partial or intermediate outputs, are for the most part readily identifiable and measurable through the operational accounting systems.

The output-effects segment represents the possibility set of performance indicators. These tend to be less readily identifiable than outputs and substantially more difficult to measure. Conceptually, this set encompasses the indicators that reflect progress in the economic, social, or physical changes that are the object of the reform. It may also include some that are not.

13. The term environment is used in the broadest sense to include all of the economic, social, and political factors that affect the goals and objectives of a nation as well as in the narrower and more usual sense of the physical, climatological, and biological surroundings.

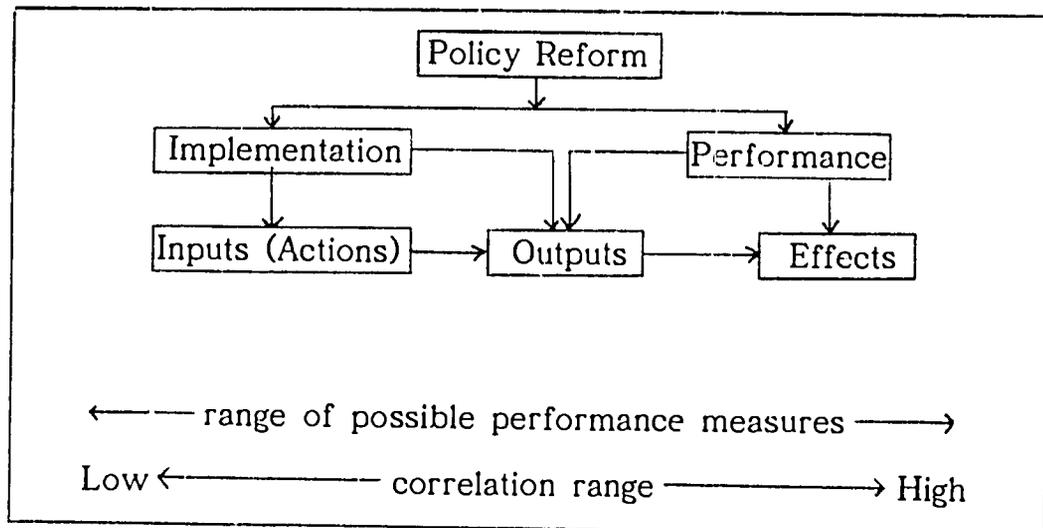


Figure 1. The Possibility Set for Identifying Performance Indicators

In the general case, there is a fairly obvious relationship between the level from which the performance measures are selected and the extent to which they provide evidence that the objectives will be obtained by the policy reform. To rely mainly on measuring the implementing activities would provide only weak to moderate evidence that the ultimate goals will be achieved. These actions are usually only a small part of a long sequence of operational steps and economic and social interactions before the end results are achieved. In this chain, the risks of something going wrong or different than planned run high. The final outcome may not be as suggested by any of the implementing steps, even though the steps may reflect the best of intentions.

Measures from the performance stage, at least conceptually, would provide stronger evidence of progress than indicators from the implementation stage. Clearly, the direct measurement of the objective itself would provide the strongest evidence of all, other things being equal. But other things, namely measurement and measurement costs, are not always equal.

Intermediate to these two extremes of performance indicators are the outputs from the delivery system, which, if properly conceived, will usually provide fairly reliable evidence of performance at moderate cost. But in a highly heterogeneous world, there are always exceptions. Evidence gleaned from inputs and implementing activities is tenuous at best. At a minimum, it will reflect the intentions of the government, which in many cases may be sufficient; but in general, it is only a weak proxy for the ultimate objective, especially when the implementing chain of activities is long and involved.

A hypothetical example of an agreement which involves, say, adjusting paddy prices in country X illustrates the comparative strength of the evidence provided at different levels in the input-output-effects spectrum. The first piece of evidence that the reform is being implemented might be a memorandum from the President to the parastatal manager requesting him to comply with the agreement. This by itself is usually not enough, although it may be encouraging. The process needs to advance further through a series of steps and intermediate outputs before the effective output stage is reached. These additional steps might include additional correspondence with the minister, several meetings of the advisory committee, legal and legislative clearances, announcements in the press and other public media, posting prices at all official buying stations, obtaining additional funding or borrowing authority to effect the necessary purchases, assuring adequate facilities for buying and storing rice, and then actually going out to buy up paddy to effect the intended price. The number of tons of paddy purchased would reflect the output from the delivery system over which the government, through its parastatal, has virtually full control.

But even if all of the foregoing steps are carried out and a certain quantity of paddy is purchased at harvest, there is still no guarantee that it was enough to effect the intended increase in price. There is also no guarantee that if the price of paddy is increased by the targeted amount, the ultimate objective -- to increase national rice production -- will be met. This failure was illustrated in Mauritania, where the elasticity of supply response to

price proved to be very low in the short and intermediate run because of the severely limited availability of land and water.

The process of selecting acceptable performance indicators therefore implies a detailed examination of the entire hierarchical possibility set. In the implementing stage, this means a careful examination of the inputs, the implementing institutions and actors involved, their specific roles in the process, the legal and administrative requirements, the consultations and clearances that are necessary, and the timing required for the process to reach the stage in which the key outputs are produced.

In the impact stage, it means obtaining an understanding of the ways in which the outputs will interact with the environment to produce the end results. It should also entail an understanding of potential side effects that may be desirable or undesirable depending on one's point of view. This measurement usually requires fairly sophisticated econometric methods that allow sorting out the impacts resulting from the outputs from those resulting from normal or extraneous forces.

The hierarchical possibility set is illustrated by an example from agricultural extension (Figure 2). Reading from the bottom up, the diagram identifies the dimensions of possible indicators at seven suggested levels in the hierarchy:

- At the inputs level, the criteria are found within plans to allocate certain kinds and amounts of resources to a program or project with the specified set of objectives.
- At the activities level, indicators are found within the bounds of the delivery system that produces and delivers an appropriate educational message (output) using various kinds of extension methods.
- Farmer involvement represents another of the early outputs of the delivery system. Indicators drawn from this set are usually defined in terms of the types and numbers of people, groups, and organizations that have been reached by the extension message.

- At the knowledge/awareness level, the indicators are found in the changed attitudes and skills of farmers and their plans to make the investments necessary to adopt the practice.
- Practice changes are among the first of the observable evidence that the results intended are being produced. The nature of the adoption curve must be considered: a new practice is adopted first by a few lead farmers; over some period of time, other farmers follow suit, but some never do.
- The end results are obviously found within the range of expected impacts, which will include the primary goals and objectives -- the reason for initiating the activities in the first place. These indicators would include measurable changes in farm income of individuals or of all farmers in the target area. The indicators could extend further to effects on national output, changes in the level of imports or exports, and increases in national income and employment. How far one goes is obviously a matter of the need to do so and measurability.

Each successive stage provides increasingly stronger evidence of progress toward the ultimate objectives. However, only the end results provide strong proof of the degree to which the objectives have been achieved. All of this assumes measurability.

Measurement Error

In the foregoing example of extension, it is significant to note that to establish veracity at levels 1 and 2 will require an examination of the accounts and records of the delivery system and an assessment of them in light of expectations and knowledge of the kinds of actions needed to implement the reform. To do so at levels 3 to 6 will require some type of survey. And for level 7, establishing veracity will require a survey of farms and a detailed econometric analysis if impacts beyond the individual farm level are among the primary objectives to be achieved.

None of these measurements can be done without recognizing the likelihood of measurement error. This limitation is always important, but

Figure 2. Hierarchy of Evidence of Performance:
The General Case for Agricultural Extension¹⁵

7. END RESULTS	Ultimate objectives Other effects
6. PRACTICE CHANGE	Individual innovation Structural change
5. KNOWLEDGE-AWARENESS	Direction and extent Duration of change
4. REACTIONS	Farmer interest Accepted by leaders
3. FARMER INVOLVEMENT	Number and type Continuity and intensity Coverage (area, crops, etc.)
2. EXTENSION ACTIVITIES	Extension methods used Subject matter conveyed
1. INPUTS	Time and personnel used Staff qualifications and support provided

especially so in the impoverished information environment of many developing nations, where public accounting and record keeping are not always fully reliable, where survey conditions do not always produce convincing results, and where the data and economic research base provides a special challenge for the econometrician.

In general, the likelihood of measurement error tends to increase as one moves along the implementation-impact spectrum of the possibility set. This likelihood has important implications for the costs associated with attempts to obtain reliable measures. In general, the measurement of inputs and observable implementing actions is least costly to obtain from the delivery system, but the evidence is not very strong. The surveys that are needed to provide stronger

15. Adapted from *Analyzing Impacts of Extension Programs*, Extension Service, U.S. Department of Agriculture, ESC-575, revised July 1977.

evidence from higher levels along the chain would be more costly than examining accounts, especially if a low degree of statistical error is required. In many developing countries, however, it is possible to survey farmers' attitudes and other characteristics at low cost. Measuring the end results with any degree of reliability is probably the most difficult and the most costly, especially if surveys are also required to support an econometric analysis. Furthermore, there is no assurance that even a substantial econometric effort will produce convincing evidence.

If adequate data are not available, consideration might be given to making provision in the agreement for collecting such data, as in several of the cases discussed in the earlier section. Such supplementary efforts can range from low cost, quick surveys to obtain key numbers to more extensive efforts that can also serve to enhance the sectoral and national database. With proper timing, such surveys or data collection efforts can also serve to establish benchmarks from which progress can be measured, which can be invaluable in negotiation.

The bottom line is that in selecting a set of performance indicators to support the negotiations associated with a non-project conditional agreement, the trade-off between the need for strong and reliable evidence of performance and the cost of obtaining it will have to be weighed. The balance will depend on the value placed on the information by the negotiators. This value will depend on the amount of leverage that is inherent in the agreement and how much of it negotiators are likely to need to exercise.

APPENDIX A

Types of Policy Conditions

A typology of the kinds of structural adjustments or policy and institutional reforms in agriculture that the World Bank and A.I.D. are pursuing is presented below.¹⁵

Pricing Policy

- Macroeconomic Instruments
 - ▶ Exchange rates
 - ▶ Wage rates
 - ▶ Interest rates

- Agricultural Instruments
 - ▶ Administered farm and consumer product prices
 - ▶ Implicit tariffs on government-imported goods
 - ▶ Rural and farm wage controls
 - ▶ Irrigation charges and cost recovery
 - ▶ Administered farm input prices
 - ▶ Differential interest rates for agriculture

15. Adapted from Roger Norton, *op. cit.*

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Fiscal Policy

- Macroeconomic Instruments
 - ▶ Public expenditure rationalization and reduction
 - ▶ Tax reform
 - ▶ Tariff adjustments
 - ▶ Subsidy changes

- Agricultural Instruments
 - ▶ Current expenditure adjustments and redirection
 - ▶ Adjustments in public investment and O&M allowances
 - ▶ Increased direct taxes and user charges
 - ▶ Adjustments of tariffs and duties on agricultural products and inputs
 - ▶ Restructured subsidies

Monetary Policy

- Macroeconomic Instruments
 - ▶ Money supply targets
 - ▶ Interest rate interventions
 - ▶ Credit allocations

- Agricultural Instruments
 - ▶ Upper or lower limits on agricultural credit availability
 - ▶ Interest rates adjusted to farmers and rural people

Trade Policy

- Macroeconomic Instruments
 - ▶ Adjustments of tariffs and quotas
 - ▶ Liberalization of trade and foreign exchange regulations
 - ▶ Adjustments of export subsidies and taxes

- Agricultural Instruments
 - ▶ Selective adjustments in tariffs and quotas
 - ▶ Special allowances for agriculture in trade and foreign exchange regulation
 - ▶ Selective adjustments in export subsidies or taxes on agriculturally related products and inputs

Institutional Reform

- Macroeconomic Instruments
 - ▶ Improved monetary and fiscal management and procedures
 - ▶ Improved management and efficiency of parastatals
 - ▶ Divestment of public enterprises
 - ▶ Improved capabilities and performance of public personnel
 - ▶ Education and training programs
 - ▶ Rationalization of regulatory activity

- Agricultural Instruments

- ▶ Marketing board and parastatal reform including possible divestiture
- ▶ Improved grading, quality control, and phyto sanitary regulations
- ▶ Improved agricultural research and market information
- ▶ Fair trade practices and contract enforcement
- ▶ Reduced intermediation costs in agricultural banks
- ▶ Improved agricultural extension and education among farmers
- ▶ Increased managerial and administrative capacity of line agencies, cooperatives, and parastatal staffs
- ▶ Development of user groups for activities such as irrigation and forestry management

Land and Tenure Policy

- Macroeconomic Instruments
 - ▶ Public versus private land ownership
 - ▶ Land taxation and cost recovery for publicly financed improvements
 - ▶ Rural and urban land use planning and implementation
 - ▶ Cadastral surveys and property assessment
 - ▶ Cost recovery for public investment in resource and infrastructure development
- Agricultural Instruments
 - ▶ Cadastral surveys and farmland assessment
 - ▶ Land taxes for revenue and land use impact

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- ▶ Sales and lease policies for farming on public lands
- ▶ Farm land titles and ownership rights
- ▶ Consolidation of individual farmer's lands
- ▶ User charges for public services and investments

These are the principal conditionalities that may be applied to non-project funding. Many other conditions could be applied in particular cases; among these is information.

In many situations, the people who draft the conditions for non-project financing will be uncertain about which policy or delivery system will be most effective in achieving particular objectives. Rather than risk the imposition of a possibly erroneous or ineffective policy reform, the agreement may, as in the foregoing examples, specify that the government should develop information that will reduce the risk of error. Depending on the amount of information needed and the amount already available, the quest for information could take a variety of forms:

- Examining the impacts of alternative policies on the major goals and objectives and on social and economic indicators of political significance
- Analyzing the effects of alternative targets, targeting strategies, delivery systems, and levels of effort or intensity of implementation
- Conducting prefeasibility and feasibility studies to determine the cost-effectiveness of public investments
- Developing strategies and detailed plans for implementation
- Conducting benchmark surveys to determine status
- Gathering specific data and information about the kinds of policy or institutional reforms that should be pursued

APPENDIX B

Niger: Monitoring Progress in Reform

The following summary is an excerpt from the report of a special team that was commissioned to assist USAID/Niger in identifying criteria that might be considered for monitoring progress toward the policy and institutional reforms that were conditions of a sector grant to the Government of Niger.¹⁶ The case illustrates the kind of measures that were recommended to verify whether progress has been made on the specified reforms. It is particularly useful for the purpose of this paper because it contains analytical comments about the problems associated with the selection of each set.

It should be noted that in most cases no time frame was specified for the accomplishments because in most cases a definite sequence had to be followed. Some activities could not logically be started until the previous ones had been completed. In other cases, a number of conflicting priorities were noted.

The implementation schedule illustrates the suggested strategy of stressing decontrol and deregulation in the early stages of the project to set the stage for later policy reforms and restructuring. The indicators of progress were not in all cases unequivocal evidence of progress. The report recognized that strong evidence of performance could not be garnered until Niger's capacity for policy analysis was strengthened. To this end, the Mission provided long-term assistance to the Government of Niger.

16. Wesley Weidemann and Theodore Cook, *Niger: Agricultural Policy and Credit Reforms*, Washington, D.C.: Robert R. Nathan Associates, Inc., July 1984.

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The following is a list of measures and concerns of the monitoring team regarding each of the reforms.

Input Supply and Subsidy Reforms

Reform Number 1

Subsidized prices will be fixed and sustained after subsidy funding and available quantity demanded are relatively certain.

Progress Indicators

- Procedures have been developed to project with reasonable certainty the amount of input likely to be demanded at different subsidized prices and the resources available to sustain the projected subsidy.
- Assurances are received from fiscal controllers that deficit financing is authorized or additional funds are available if needed to sustain an announced price or subsidy.
- Farmers in all areas of the country are able to buy all of the inputs they want at the established price. No widespread shortages are reported.

Comment

- Spot shortages may develop in certain areas of the country because of logistical problems or because of restructuring of the CA.
- External factors such as changing input subsidies in Nigeria may intervene.
- If the GON is willing to allocate additional subsidies if demand is underestimated, timing is more important than the actual net price.
- Delays in announcing prices could lead to non-availability of inputs at critical times and prove to be counterproductive.

- The exploration and testing of new methods of calculating and delivering subsidies should continue.

Reform Number 2

Develop more efficient and effective means of subsidizing farm inputs.

Program Indicators

- GON, in consultation with USAID, prepares a report on alternative methods of analyzing and delivering input subsidies and has determined the comparative cost-effectiveness in stimulating farm output.
- Report is presented to USAID.
- GON and USAID discuss conclusions of report.
- GON develops a plan and timetable for instituting an agreed-upon system for delivery of subsidies.
- In the interim, subsidies are fixed on a per unit basis.

Comment

- Alternative methods of delivery of subsidy may include a rebate system, coupons, reduced interest on loans, and subsidized inputs ex-factory or ex-warehouse. A mixed system of subsidy delivery could be the most efficient and effective.
- A related analysis needs to be done to determine which input subsidies should be retained and at what level.
- See also reform number 1.

Reform Number 3

Maximum subsidy on any input will be reduced immediately toward 50 percent.

Progress Indicators

- Ministry of Rural Development, following its detailed analysis of the subsidy situation, indicates that the reform has been carried out.
- Prices paid by farmers are more than 50 percent of the cost of inputs (f.o.b. port) plus transportation and handling.

Comment

- External factors such as sudden shifts of input subsidy policy in Nigeria or changes in world market prices could disrupt an otherwise well-conceived implementation plan.
- Assumption is that the methodology used to calculate subsidy level is accepted by USAID as valid indicator.
- A study to determine the farm demand for various inputs at different subsidized prices would provide a better basis for determining subsidy level on selected inputs.
- See also reforms number 1 and number 2.

Reform Number 4

Rate of subsidy will be adjusted toward a maximum average level of 15 percent by the end of the program.

Progress Indicators

- Ministry of Rural Development reviews the subsidy situation and develops a plan for adjusting input prices.
- Results of the review are discussed between USAID and the GON.
- GON develops a timetable and means of verification satisfactory to USAID.

Comment

- Ministry of Rural Development will likely need outside technical expertise to carry out a satisfactory review.
- A related study to determine which subsidies will be retained at which level and the impact of these subsidies would be useful at some later time.
- See "Input Subsidy Studies."
- See also reform number 2.

Reform Number 5

Implement and maintain a policy environment in support of the proposed restructuring of the CA.

Progress Indicators

- Substantial progress is made in reforms 1-4 and 6.
- The monitor for the Agricultural Production Support Project is able to report improvement in the policy environment in his report.

Comment

- Any discrepancies will have to be discussed directly with the GON.

Reform Number 6

Farmers will be permitted to obtain credit for purchasing partial animal traction and technical packages.

Progress Indicators

- The CNCA changes its procedures to reflect the above reform.
- Significant numbers of farmers are known to receive loans for partial packages.
- If CNCA is phased out, the successor organization will issue credit for partial packages.

Comment

- Should be easy to verify from CNCA records.
- Nonavailability of credit may make this difficult to verify if there is a fundamental restructuring of CNCA.

Pricing and Marketing Reforms**Reform Number 7**

Private traders will be able to participate in primary marketing of grain during the official buying campaign as well as at other times.

Progress Indicators

- Administrative decree announcing the policy is published.
- Restrictive regulations are removed or not enforced.

Comment

- Professional licensing and rules conducive to fair practices should be permitted if they do not restrain entry or minimize competition.

Reform Number 8

All restrictions and fiscal impediments on the free movement of grain across all provinces in the country will be removed.

Progress Indicators

- No tax or other restraints on movement of grain are in effect within one year of signing the ASGD.

Comment

- Emergency food aid distribution is exempted.
- No reimposition of restrictions on internal trade will be permitted during the life of the project.

Reform Number 9

A system of bidding and tendering will be implemented to encourage competition in the purchase and sale of grain for OPVN.

Progress Indicators

- Two experimental tenders to purchase and two to sell are completed in the first year of the project.
- The experience of the pilot tenders and other information is analyzed to determine the feasibility of developing and institutionalizing a tendering system.
- Some of OPVN's reserve stock should be replenished by the end of the second year of the project by tenders from cooperative and price market traders.
- Some of OPVN's reserve stock turnover will be sold through a tender system by the end of the second year.

- By the end of the project, 25 percent of OPVN's stock should be rotated each year using tenders offers and bids from cooperatives and private market intermediaries.

Comment

- Technical assistance may be required to study the results of the pilot tenders and to set up and redefine a tender system.

Reform Number 10

Establish and promote village-level grain storage through arrangements with cooperatives.

Progress Indicators

- With the cooperation of OPVN, alternative means of storing grain in villages are explored and reported to decision makers.
- Agreed-upon plans are prepared by OPVN to implement a storage plan.

Comment

- See reform number 11, also "Managing Grain Stocks."

Reform Number 11

Reduce total OPVN grain stock level in order to reduce storage costs and improve OPVN's financial position.

Progress Indicators

- OPVN grain stocks are reduced to less than 100,000 tons by the end of the third buying campaign after the signing of the ASDG.
- An analysis is completed in cooperation with OPVN to suggest means of reducing storage costs, improving OPVN's financial position while maintaining adequate emergency stocks in the country.
- OPVN and USAID discuss options, and OPVN prepares and implements a satisfactory plan.

Comment

- Some of the stock can be shifted to coops and private traders who store under bond.
- Might consider using village level storage as part of price stabilization program.
- See reform number 10, also "Managing Grain Stock."
- The amount of grain stored in private sector bonds at the farm level is not known.

Reform Number 12

Abandon uniform national pricing of cereals at the producer and consumer level.

Progress Indicators

- Rules and regulations to hinder the competitive activities of grain traders are relaxed or abandoned.
- No legal or administrative rules to require regional uniform pricing of cereals are in effect.

Comments

- Emergency situations will be excluded.
- See reform numbers 7, 8, and 9.

Reform Number 13

Provide market information on prices of cereals, legumes, and livestock to the *arrondissement* level.

Progress Indicators

- An appropriate price reporting system is developed within one year of the start of the project.
- Weekly radio broadcasts of key market situations and prices are begun.
- By the end of the program, market information for 75 percent of all *arrondissements* will be available on weekly broadcasts.

Comment

- See "Market Information Service."

Reforms on Border Trade with Nigeria**Reform Number 14**

The process for obtaining trading permits and export licenses will be simplified.

Progress Indicators

- All required documentation is obtainable at convenient locations such as a department capital or customs border posts.
- Obtaining permits and licenses is not subject to unreasonable fees and charges.
- Obtaining required documents does not take an unreasonable amount of time (one day).
- Information required on applications pertains reasonably to the purposes of the document sought.

Comment

- See reform number 15.

Reform Number 15

Lower barriers to participation by small traders in import and export activities.

Progress Indicators

- Licensing fees for livestock and cereal exports are proportional to actual volumes exported.
- Exporters and importers of small quantities of grain (less than 5 tons) and livestock (fewer than 10 head) are able to obtain licenses expeditiously at border posts.
- Small traders are free of all trading restrictions except those pertaining to animal health.

Comment

- See reform number 14.

Reform Number 16

Establish and maintain freedom of trade in cowpeas and peanuts.

Progress Indicators

- Public sector agencies, cooperatives, and private traders will have unrestricted and equal authority to export cowpeas.
- Unrestricted and equal authority to export peanuts will be extended to all public sector agencies, cooperatives, and private traders.

Comment

- Measures are similar to reforms 14 and 15.

Reforms to Privatize the Marketing System**Reform Number 17**

Cooperatives and private businessmen will be allowed to perform the input distribution function.

Progress Indicators

- An administrative decree is issued which authorizes cooperatives and private traders to buy, sell, transport, store, process, or otherwise handle agricultural inputs.
- No restrictions are placed on cooperatives and private businessmen other than regulations designed to ensure fair competition.

Comment

- See reform number 7.

Reform Number 18

Free market pricing will prevail in markets for agricultural inputs.

Progress Indicators

- GON has taken steps to avoid market collusion and ensure competition.
- All market participants are free to buy from anyone or sell to anyone at privately negotiated prices.

Comment

- Steps to avoid collusion are vague. Would include assuring market access, providing information on market conditions, etc. May have to consider legislation that would provide legal sanctions against market collusion and restraints on trade.
- See "Input Subsidy Assessment."

Reform Number 19

The GON will promote the role and importance of cooperatives in supplying inputs to farmers and marketing grain and other agricultural products.

Progress Indicators

- Cooperatives are given pricing freedom for buying and selling agricultural inputs, grain, and other products.
- Cooperatives are allowed to reorganize themselves into more rational units.
- Cooperatives are encouraged to undertake grain storage either on their own account or under contract with OPVN.
- Credit is given to cooperatives at market rates for financially viable investment and trading activities.
- Cooperatives are permitted and encouraged to buy, sell, store, transport, process, export, or otherwise participate in commodity and input markets.
- Cooperative managers and employees are hired and fired by cooperatives.
- Cooperatives will pay an increasing proportion of the salary of cooperative employees until they are completely financed by the cooperative.

Comment

- Cooperatives will not be granted monopoly or monopsony powers by the GON.
- See reform number 20.

Reform Number 20

The GON will actively promote cooperatives and private traders as intermediaries in primary marketing of grain and other agricultural products.

Progress Indicators

- Government decrees authorize participation of cooperatives and private businessmen in buying, selling, storing, and transporting grain and other agricultural products.

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Comment

- See reform number 19.

Agricultural Credit Reforms

Reform Number 21

A more effective means of delivering financial services in rural areas will be started and strengthened.

Progress Indicators

- A study of rural credit is undertaken jointly by USAID and GON and produces an agreed-upon set of system reforms.
- An agreed-upon implementation schedule is developed and effected.

Comment

- See "Rural Financial Markets Study" and Annex A.

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APPENDIX C

Nepal's Structural Adjustment Program Policy Matrix

The following five policy areas and the objectives and targets pertaining to them were a significant part of the agreement between the World Bank and the Government of Nepal for a structural adjustment loan in early 1987. The first tranche was made available on the basis that the government had already committed itself to undertake a number of policy reforms. Other reforms were specified for accomplishment before the second tranche of the loan was granted. The second tranche was based on the report of a supervision (monitoring) team that indicated good progress as of November 1987.

The objectives, targets, and conditions agreed upon are listed below. Following each of them is the status of performance of the various indicators that were selected, updated to July 1988.

Macroeconomic Policy

A major objective of the structural adjustment loan was to promote balanced growth by achieving the following targets for GDP by 1990-91: hold the fiscal deficit to 11 percent; hold domestic financing to 1.5 percent; raise development spending to 16 percent; raise government revenue to 12 percent; hold regular government spending to 7 about percent; raise government surplus to 5 percent; and raise foreign aid use to 10 percent.

The accomplishments were as follows:

- Signed an agreement with India to prevent double taxation
- Introduced sales tax credit system on imports of raw materials
- Established separate sales tax offices in six major urban centers, and created a post of deputy director within the Tax Department to supervise sales tax collections
- Revised and improved existing tax laws, and conducted workshops to train officers and junior technicians joining the Revenue Department
- Liberalized interest rates, allowing commercial banks to set interest rates on deposits and lending within prescribed limits
- Increased minimum reserve requirements to include minimum deposit provision
- Imposed ceilings on net domestic assets and credit expansion by monetary authorities
- Licenced two new commercial banks with foreign partners
- Devalued the rupee by 14.7 percent and adopted a currency basket system to manage the exchange rate

Development Expenditure Policy

The commitments to the development program were to increase steadily the level and the quality of investment and operations and maintenance expenditures through improvements in project identification, management, and resource control.

The performance reported for the selected indicators was as follows:

- Introduced program budgeting procedures for agriculture, irrigation, forestry, power, transportation, education, and health; conducted rudimentary analysis of all projects
- Identified a "core" development program
- Installed a project monitoring and control system

- Gave more authority to project managers and other senior government officials for personnel management and spending (gazetted and notified in January 1986)
- Increased utilization of foreign aid from 6.9 percent of GDP in 1985/86 to 8.2 percent in 1986/87
- Started to make improvements in audit and accounting procedures

Industrial and Trade Policy

A move toward a more liberal policy regime was the primary objective for industry, exports, and imports. The progress reported in this area showed that the government had

- Implemented industrial policies to conform with policy statements that had been issued
- Freed 23 industrial items of requirements for industrial licensing in January 1986
- Established criteria to liberalize licensing requirements for non-exempt industries significantly
- Formulated and introduced a program of income, sales, and excise reforms
- Converted the tariff structure to a seven-band system ranging from 0 to 100 percent
- Introduced trade taxes and revised tariff rates on imports of raw materials in the FY 1987 budget, ranging from 1 to 10 percent according to type of raw material imported
- Implemented a program to improve and streamline procedures for exporting and importing
- Converted the export list from "items free" of export licensing to "items requiring" licensing
- Introduced a policy of open general licensing
- Initiated an auctioning procedure for import licenses on products subject to quantitative restrictions

- Introduced a passbook system for imports of industrial raw materials
- Established a two-tier export development committee, one headed by the Minister of Commerce, the other by the Governor of the Nepal Rastra Bank
- Introduced a mechanism for allocating U.S. garment quotas before the start of each year

Agriculture and Forestry Policy

Because of the overriding importance of agriculture and forestry in the economy, a major emphasis was placed on these sectors, specifically on

- Fertilizer -- To increase the supply and timely availability of appropriate fertilizers, improve economic returns on investment, and reduce losses
- Seeds -- To improve supply and timeliness especially for major food grains; improve the efficiency of main institutions in the seed sector; promote greater private sector participation; and expand seed production, marketing, and distribution
- Food Grain Marketing and Distribution -- To increase food grain production and security throughout the country, stabilize consumer prices, and provide producer incentives
- Agricultural Research -- To improve the management of the agricultural research activities, expedite the development and testing of improved technology, and improve the utilization of manpower
- Forestry -- To improve the role of the Panchayats (local governments) in developing, managing, and utilizing local forestry resources

The following accomplishments with respect to the fertilizer requirements were reported:

- Prepared a time-bound action plan for strengthening the Agricultural Input Corporation's financial viability.

- Introduced a comprehensive program to improve the pricing and distribution of fertilizer.
- Increased fertilizer retail trading margins by 2 percentage points, and initiated a semi-annual review of wholesale fertilizer prices.
- Made specific provision in the budget to defray the excess of costs over revenues.

The government's accomplishments toward meeting commitments with respect to the seeds sector included the following:

- Implemented a simplified cereal seed sales pricing system, including elimination of subsidy on seeds.
- Provided greater financial autonomy to the Seed Division of Agricultural Input Corporation.
- Established a National Seed Board.
- Designated farms for the production of foundation seed.
- Initiated a program to improve hill farmers' access to seeds.
- Introduced smaller, more appropriate size bags for transporting and marketing certified cereal seed.

The government claimed the following accomplishments in food grain marketing and distribution:

- Prepared and started work on a time-bound action plan to restore the financial viability of the National Food Corporation.
 - Initiated steps to strengthen the corporation's accounting system, including separating accounts for commercial activities and those associated with government's welfare programs.
 - Initiated a time-bound action plan for other public sector entities to settle their overdue obligations to the corporation.
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- Abolished the food grain procurement levy.
- Involved the Sajhas (local cooperatives) in food grain procurement.
- Initiated a market-oriented consumer price stabilization program in the Kathmandu Valley.
- Submitted to the Auditor General's office complete accounts of the Agricultural Input Corporation and the National Food Corporation activities for all years through 1985/86.
- Provided sufficient budgetary support to compensate the Food Corporation for the costs of carrying out welfare-oriented functions on behalf of His Majesty's Government.
- Initiated criteria for identifying consumer groups vulnerable to chronic or severe seasonal food shortages and for targeting food grains to such groups.

The main commitment for research resulted in the establishment of a research policy body, the National Agriculture Research Committee; a permanent secretariat to serve that committee; and the National Agriculture Research Services Center, to plan and administer the research program approved by the policy body.

The only forestry policy reform in the agreement was accomplished to allow forest user groups to retain 100 percent of revenue from forest activities.

Public Enterprise Policy

A significant commitment, both politically and economically, was to limit the scope of public enterprise activity and improve the efficiency of the remaining ones. The activities completed in this regard, as of July 1988, included the following:

- Set physical and financial targets for annual performance with quarterly evaluation.

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- Increased sales prices of commodities to reduce the consumer subsidy.
- Floated public shares for some public enterprises.
- Categorized public enterprises into those to retain, sell in part, or sell outright.
- Placed limits on borrowing by public enterprises.
- Prepared action plans for closure, divestiture, or managerial reform.
- Initiated steps towards privatizing the entities selected.

