TOWARDS A NEW ERA IN DEVELOPMENT AID: BUILDING EFFECTIVE INSTITUTIONAL INFRASTRUCTURE IN LESS DEVELOPED COUNTRIES

A report for FRIDE
Volume II: The Country Studies

Table of Contents

COUNTRY STUDIES: FIELD WORK, WORK PLAN

The following pages provide the models of the basic documents used by the DFC team members as guidelines for their country visits. As the objective of these country visits was, fundamentally, to provide a judgement on the country's Institutional Infrastructure, the documents provide for each component:

• The basic question to address;
• The key issues to analyse and the type of information to be obtained;
• The research work needed to back up the answers to the questions listed;
• The type of field work interviews that should be attempted as providers of well founded judgements on each question.

In addition, we present the main criteria to be used in evaluating the I.I. so that all DFC team members handling individual countries would have a common understanding of the concept, approached it the same way and, thus, produced comparable results.

COUNTRY STUDIES: FIELD WORK, WORK PLAN

Question Political System	Key Issues/Information Required	Research Source	Field Work
Does the Constitution (written or not) provide an effective and stable basis for the exercise of political power?	**1. Review of Constitution/Political system** • Division of Powers (executive v legislative) • Checks on executive power (impeachment through legislative or disqualification through courts). • Democratic elections • Legal opposition • Decentralised participation in decision-making? **2. Extent of social unrest/civil conflicts** **3. Soundness and Stability of Macro-economic management** • management of inflation • fiscal policy • external debt • poverty reduction **4. Aid management and co-ordination** Is development aid effectively co-ordinated and administered? One Ministry?	Standard reference sources (Encyclopaedia Britannica? EIU) WB Index Voice & Accountability Freedom House Assessment (www.freedomhouse.org) WB Index Political Stability EIU Country Risk Reviews DRI Country Risk Reviews WB PREM/DEC indicators of macro-economic policies (see Country Policy and Institutional Assessment (CPIA) 2001 questionnaire. IMF programme status (current and past 10 years) ICRG Country Risk Rating (WDI) Human Development Index (HDR 2001 UNDP)	General conversations with impartial observers, taxi drivers! Obtain and review • Government statements of macro-economic policy, and • commentary by independent observers (e.g. research institutes). Field interviews with donors, bankers and independent observers.
Are the political institutions (executive, legislative and administrative) effective and democratically responsive?	1. Dates and results of presidential/legislative elections in past 5 years (has there been peaceful change of power based on elections)	Standard reference sources EIU Country Risk assessment	Field interviews with donors, bankers and independent observers

Is the key administrative agency of government macroeconomic and aid coordination (Ministry of Finance) effectively managed?	**1. Objective setting and accountability** • Does the institution have a clearly defined set of objectives? • Are these objectives compatible with the effective use of aid (in terms of priorities and efficiency)? • Does the institution publish regular reports that allow it to be held accountable for performance?		Interviews with "economic observers", bankers, donors, researchers, journalists.
	2. Quality of Personnel • Is the Top Management adequately qualified for the post (both in functional and managerial terms)? • Are the middle management group adequately qualified (both in functional and managerial terms)? • Is there sufficient interchange of personnel with other agencies/public sector?	See WB website www1.worldbank.org/publicsector/civilservice	
	3. Effective decision-making • Are major decisions taken with rational and predictable regard for the overall objectives of the institution? • Are policy decisions generally applied promptly and effectively? • Are policy decisions made and applied without unwarranted political interference?		
	4. Efficiency of procedures • Are procedures governing routine activities clearly defined and free of "red tape"? • Are routine activities (application of policies) handled in a timely manner? • Do procedures allow for review and appeal?		
	5. Cost/waste • Is the institution subject to budgetary discipline? i.e. its expenditures require prior approval by a supervisory authority • Are overall costs reasonable in relation to benefits? • Are any activities clearly wasteful?	See Journal of Public Economics 76 (2000) "dodging the grabbing hand" Eric Friedman et al.	
	6. Corruption • Are irregular payments prevalent to "get things done" with this agency? • Are these payments seen as damaging the effectiveness and integrity of the agency? • Are foreign partners (donors and business) seen as promoting, acquiescing or resisting corruption?	WB Control of Corruption Index (KAMS)	

COUNTRY STUDIES: FIELD WORK, WORK PLAN

Question Legal Framework	Information Required	Research	Field Work
Do the laws of the country provide an effective and stable basis for protecting property rights and the enforcement of contracts?	• Summary (date and coverage) of Company and Bankruptcy laws • Are major disputes brought to court/ decided equitably? Landmark cases	Standard reference sources WB Governance Indicators on "Rule of Law"	Interviews with private lawyers, and "economic observers", bankers, researchers, journalists.
Is the court system soundly established? Including staffing by qualified judges.	• Structure of court system (does this provide for specialised courts for commercial cases, bankruptcy) • Who appoints judges? Qualifications?	Standard reference sources	Interviews with private lawyers, and "economic observers", bankers, researchers, journalists.
Does the court system operate effectively?	See 6 questions under Political System.	WB Governance Indicators on "Rule of Law"	Interviews with private lawyers, and "economic observers", bankers, researchers, journalists.

COUNTRY STUDIES: FIELD WORK, WORK PLAN

Question Financial System	Information Required	Research Source	Field Work
Do the rules (laws and regulations) provide a sound basis for the development of (a) banking system and (b) capital markets fostering the mobilisation of savings and efficient financial intermediation?	**1. Summary (date and coverage)of** • Banking Law (does this provide for independence of the central bank, open access to foreign banks, adequate supervisory authority) • Capital Markets **2. Soundness of Banking System** • Extent/trend of banking penetration • Commercial bank assets/GDP • Ratio of bank branches/population • competition in the banking sector? % of banking assets in public, private and foreign banks (trend over 10 years) • Is the level of NPL in banks so high as to threaten the integrity of the banking system?	Standard reference sources IMF/WB country reports WB PREM/DEC Indicators on Financial Sector. WEF 2002 (KAM) WB/IMF country reports Central Bank reports	Interviews with "economic observers", bankers, donors, researchers, journalists.
Are (a) financial institutions and (b) regulatory (Central Bank, SEC, etc.) soundly established?	**3. Is Central Bank legally and practically independent?** Does the CB (or other body) have clear mandate to regulate banks and NBFIs? **4. Does regulatory regime conform to best international practice ref.** • Capital adequacy requirements • Accounting and disclosure • Connected lending	WB, The Regulation and Supervision of Banks Data Base IMF/WB country reports	Interviews with "economic observers", bankers, donors, researchers, journalists.
Do (a) financial institutions and (b) regulatory institutions operate effectively?	See 6 questions under Political System.	See 6 questions under Political System.	Interviews with "economic observers", bankers, donors, researchers, journalists.

COUNTRY STUDIES: FIELD WORK, WORK PLAN

Question Corporate Governance	Information Required	Research Source	Field Work
Are there adequate rules defining the application of the Principles of Corporate Governance? [1]	**1. Are there rules governing:** • The rights of (minority) shareholders, esp. ref. equal access to information) • Disclosure requirements • Responsibilities of Directors • Environmental protection	Check OECD/World Bank Regional Roundtables on Corporate Governance. www.worldbank.org/wbi/governance Existence of an environmental policy framework (WDI Table 3.14) CO_2 emissions/population (WDI)	Interviews with "economic observers", bankers, donors, researchers, journalists.
Are there organisations in place to administer and enforce the rules?		Check OECD/World Bank Regional Roundtables on Corporate Governance. www.worldbank.org/wbi/governance	Interviews with "economic observers", bankers, donors, researchers, journalists.
Are these organisations effectively managed?	See 6 questions under Political System.		Interviews with "economic observers", bankers, donors, researchers, journalists.

1 See OECD Principles.

COUNTRY STUDIES: FIELD WORK, WORK PLAN

Question Trade and Competition	Information Required	Research Source	Field Work
Do the rules (laws and regulations) provide a basis for open access and competition in all sectors of the economy?	**1. Extent of Competition** **2. Competition Regime** **3. Effectiveness of Competition policies** • Investment Code • Number of companies established p/a (trend) • Average customs tariffs	WB PREM/DEC Indicators on Private Sector network Global Competitiveness Report WEF 2000 Ease of starting new business Heritage Foundation Index of Tariff & Non-tariff barriers	Interviews with "economic observers", bankers, donors, researchers, journalists.
Are there organisations in place to administer and enforce the rules?	**1. Does a competition agency exist?** **2. Does a Foreign Investment agency exist?**	WB Country Reports	Interviews with "economic observers", bankers, donors, researchers, journalists.
Are these organisations effectively managed?	See 6 questions under Political System.		Interviews with "economic observers", bankers, donors, researchers, journalists.

EVALUATING THE INSTITUTIONAL INFRASTRUCTURE

In approaching the planning of the country studies, and in particular thinking about how we assess whether the Institutional Infrastructure (II) (comprising a disparate range of government and regulatory agencies) is effectively managed, we need to try to define a few standard and specific criteria, and to identify the few target institutions that are critical elements of the II and can be taken as a proxy for the state of the II in the country as whole.

We need to be more specific for three reasons.

1. Simplicity. To be able to manage the subject (many possible institutions and possible criteria) we need to limit the number of criteria we apply, particularly as we shall want to translate the results into a numerical score card with some quantitative validity.
2. Relevance. By pre-selecting the criteria, rather than relying on unstructured interviews we increase the chances of making the results interesting.
3. Comparability. A standardised approach should help ensure that all team members handing individual countries have a common understanding of the subject and produced comparable results.

Criteria of Management Effectiveness

The attached table lists 6 key criteria and the essential questions that the team should cover, particularly in the field interviews.

Selection of Indicative Institutions
We should focus our analysis on the following institutions in each country (allowing for local peculiarities).

EVALUATING THE INSTITUTIONAL INFRASTRUCTURE

Element in the I.I.	Indicative Institutions
Political System	Ministry of Finance (or other Ministry which has the lead role in managing development aid)
Legal Framework	Commercial Court (or, if it does not exist, highest court handling commercial cases)
Financial System	Central Bank (or other agency responsible for regulating the banking system) and main banks.
Corporate Governance (aka Corporate behaviour)	Central Audit Organisation (or similar standard setting agency)
Trade and Competition	Customs Department (a limited role in policy but critical to use of aid funds!)

EVALUATING THE OPERATIONAL EFFICIENCY

Criterion	Key Questions
1. Objective setting and accountability	• Does the institution have **a clearly defined** set of objectives?
	• Are these objectives compatible with the **effective use of aid** (both in terms of targeting to priority uses and efficiency)?
	•Does the institution publish **regular reports** that allow it to be held accountable for its performance?
2. Quality of Personnel	• Is the **Top Management**[2] adequately qualified for the post (both in functional and managerial terms)?
	• Are the **middle management** group adequately qualified (both in functional and managerial terms)?
	• Is there sufficient **interchange** of personnel with other agencies/public sector?
3. Effective decisions-making	• Are major decisions generally taken with a **rational** and predictable with regard for the overall objectives of the institution?
	• Are policy decisions generally applied **promptly and effectively**
	• Are policy decisions made and **applied without unwarranted political interference?**[3]
4. Efficiency of procedures	• Are procedures governing routine activities **clearly defined** and free of "red tape"?
	• Are routine activities (application of policies) handled in a **timely** manner?
	• Do procedures allow for **review** and appeal?
5. Cost/waste	• Is the institution subject to **budgetary** discipline? i.e. its expenditures require prior approval by a supervisory authority
	• Are overall costs **reasonable** in relation to benefits?
	• Are any activities clearly **wasteful?**
6. Corruption	• Are irregular payments **prevalent** to "get things done" with this agency?
	• Are these payments seen as **damaging** the effectiveness and integrity of the agency?
	• Are foreign partners (donors and business) seen as promoting, acquiescing or resisting corruption?

2 In the case of a Ministry consider both the Minister and the highest-ranking civil servant.
3 NB, corruption is dealt with separately below.

MODEL SCORECARDS: INSTITUTIONAL INFRASTRUCTURE AND MANAGEMENT

OVERALL SCORECARD

		Quality[4]					
		1	2	3	4	5	6
Political System	Rules						
	Structure						
	Management[5]						
	Combined Rating						
Legal Framework	Rules						
	Structure						
	Management						
	Combined Rating						
Financial System	Rules						
	Structure						
	Management						
	Combined Rating						
Corporate Governance	Rules						
	Structure						
	Management						
	Combined Rating						
Trade & Competition	Rules						
	Structure						
	Management						
	Combined Rating						

4 Rating scale 1 (low) to 6 (high)
 1 Fundamentally unsound
 2 Unsatisfactory
 3 Inadequate
 4 Satisfactory
 5 Good
 6 Consistently good

5 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability						
	Quality of Personnel						
	Effective Decision Making						
	Efficiency of Procedures						
	Costs / Waste						
	Corruption						
	Combined Score						
Legal Framework	Objective Setting & Accountability						
	Quality of Personnel						
	Effective Decision Making						
	Efficiency of Procedures						
	Costs / Waste						
	Corruption						
	Combined Score						
Financial System	Objective Setting & Accountability						
	Quality of Personnel						
	Effective Decision Making						
	Efficiency of Procedures						
	Costs / Waste						
	Corruption						
	Combined Score						
Corporate Governance	Objective Setting & Accountability						
	Quality of Personnel						
	Effective Decision Making						
	Efficiency of Procedures						
	Costs / Waste						
	Corruption						
	Combined Score						
Trade & Competition	Objective Setting & Accountability						
	Quality of Personnel						
	Effective Decision Making						
	Efficiency of Procedures						
	Costs / Waste						
	Corruption						
	Combined Score						

COUNTRY REPORT - IVORY COAST

THE MIRACLE MISAPPROPRIATED

1. DEVELOPMENT PERFORMANCE

Ivory Coast is West Africa's second richest country (after Nigeria) owing to the boom of its cocoa and coffee sectors since the 50s. As a large African country endowed with relative political stability, at least until recently, Ivory Coast has attracted large volumes of aid from major donors.

1.1 Economic performance

The Ivorian "economic miracle", being highly dependent on a few export crops[6], came to an abrupt end in the early 80s with the drop in commodity prices. The ensuing negative GDP growth, macro-economic instability and escalating external debt forced the country into BWI-sponsored adjustment, which, with the exception of short "off track" periods, has been pursued until now. Since the CFA devaluation in 1994, which was carried out in response to pressure from the BWIs, improved competitiveness has again ensured strong growth rates (see exhibit 1).

However, the 1999 coup, together with yet another, simultaneous drop in cocoa and coffee prices, caused a recession in 2000, with GDP contracting by 2.5%. The prognosis over the medium term hinges on social and political stability, disciplined financial policies, the return of investor confidence and the resumption of external financial assistance[7] (IMF, 2001). Against this background, the IMF is forecasting a growth rate of 3.7% in 2002 rising to 5% in 2004.

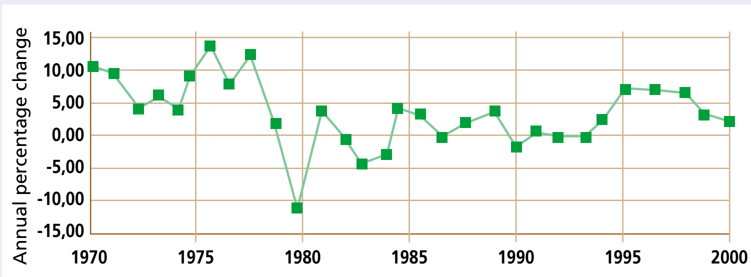
Economic Reforms and external debt

Ivory Coast being part of the CFA monetary zone, with the CFA franc pegged to the Euro, fiscal policy represents the main instrument available to government to achieve macroeconomic stabilization[8]. Unfortunately, the record has not been consistent, with overall fiscal deficit reaching a high of 16.6% of GDP in 1989 (see exhibit 2). Despite heavy IMF intervention aimed at bringing the budgetary situation under control – an Extended Fund Facility in 1981, followed by six Standby Agreements between 1984 and 1991 and various debt rescheduling schemes – the authorities were unable to reign in a growing public debt. Following the 1994 devaluation the deficit was reduced through various fiscal measures that include rationalizing the tax system, limiting wage increases and reducing the number of civil servants. In 1998 the fiscal deficit was brought down to a mere 1.2% of GDP. The overall budget deficit declined again to 3.2% in 1999, but regained position in 2000 on the heels of lower-than-budgeted capital spending[9].

As a result of this unbalanced fiscal policy stance, external debt soared in real terms from US$1.6 billion in 1970 to a high of US$17.4 billion in 1996 and stood at US$13.2 billion in 1999, representing 117.5% of GDP (see exhibit 3). Ivory Coast has been a Heavily Indebted Poor Country (HIPC) since 1998, which has allowed the stock of external debt to fall significantly as the country benefited from debt cancellation by a number of bilateral and commercial creditors. However, relations with the IMF were broken off in 1999 and Ivory Coast accession to the HIPC process was interrupted until March 2002.

REAL GDP GROWTH IN IVORY COAST

Exhibit: 1



Source: World Economic Outlook Database, IMF

CENTRAL GOVERNMENT DEFICIT AS % OF GDP

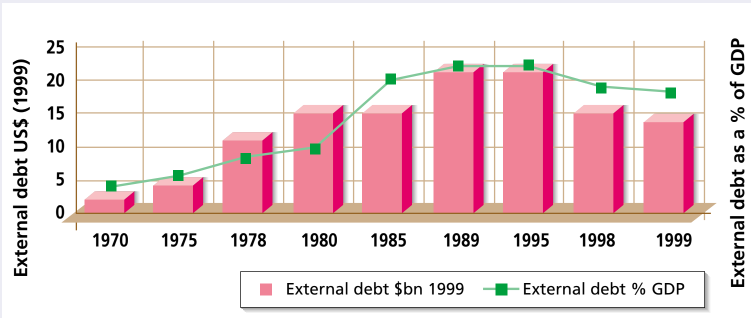
Exhibit: 2

	1979	1980	1984	1989	1995	1996	1997	1998	1999
Govt. deficit (-) surplus (+)	-9.1	-11.0	-3.1	-16.6	-3.0	-2.3	-2.3	-2.4	-3.2

Source: International Financial Statistics, IMF, various

EXTERNAL DEBT IN IVORY COAST

Exhibit: 3



Source: IMF, various

6 Ivory Coast is a primarily agricultural country, with food and export crops accounting for more that 25% of GDP (2000).
7 EU funding, bilateral, WB etc.
8 The exchange rate is pegged to the French franc and monetary policy is decided by the BCEAO.
9 IMF, 2002.

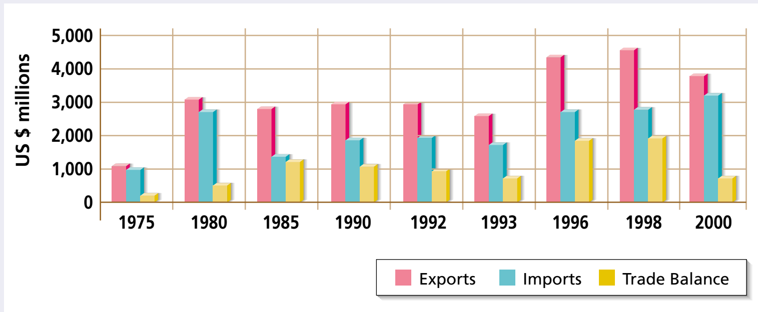
As mentioned above, since 1981 Ivory Coast has undertaken a programme of reforms encompassing virtually every area of economic policy and most key economic institutions. Major reforms have included privatisation and state withdrawal from the all-important cocoa, coffee and energy sectors. Despite strong public discontent over these reforms, the price stabilisation fund, Caistab, was disbanded and replaced by a semi-public advisory and regulatory body, which became completely private in April 2000. Privatisation began in 1992 and later gathered speed with the 1994 devaluation and subsequent IMF programmes. About 60 firms were privatised up to 1999, chiefly in the commodity sector, including SOGB (rubber, 1995), Palmindustrie (palm oil, 1996), Sodesucre (sugar, 1997), CIDT (cotton – privatisation still underway), SICF (railways, 1994) and CI-Télecom (telecommunications, 1997).

1.2 Trade

Since independence, Ivory Coast has followed an export-oriented policy led by cocoa and coffee. Consequently, trade, and indeed GDP, have been over the decades highly sensitive to fluctuations in international prices for these products and to weather conditions. During the 70s, the development of cocoa and coffee production for export together with the export-oriented policy and the boom of commodity prices at the end of the 70s, led exports to a huge increase (from US$1,238 million in 1975 to US$3,012 million in 1980 (see exhibit 4).

TRADE IN IVORY COAST

Exhibit: 4



Source: IMF and World Bank

MAIN EXPORT PRODUCTS IN IVORY COAST (% OF TOTAL EXPORTS)

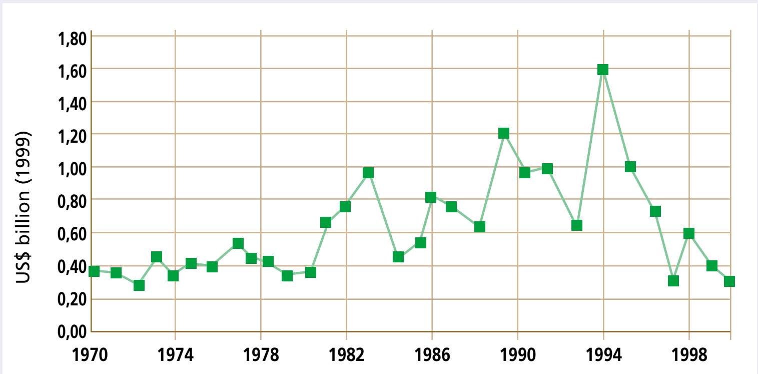
Exhibit: 5

	1990	1999	2000
Cocoa	22%	30%	21%
Fuel	n.a.	4%	4%
Manufactures	37%	31%	34%
Others	n.a.	35%	41%

Source: World Bank

NET PUBLIC FLOWS (ODF) IN IVORY COAST

Exhibit: 6



Source: OECD DAC Online Database

In the same period imports also increased at an annual growth rate of 21%. When commodity prices started falling, exports and imports suffered an important decrease of 2% p.a. and 12 % respectively (from 1980 to 1985).

From 1985 to 1993, the deterioration in the terms of trade (collapse of cocoa and coffee prices) and the appreciation of the real effective exchange of the CFA Franc did not help Ivory Coast trade to improve. Exports decreased by 1.3% p.a. and imports by 3%. The low level of investment made the trade balance remain positive during the period.

From 1994 to 1998, more favourable terms of trade together with large external assistance and rigorous macroeconomic policies enabled trade in Ivory Coast to recover. Exports rose more than 13% p.a. and imports by 9% p.a. in the period. But in 1999 and 2000 the contraction of the secondary sector (decline by 37% in the textile and garment sector and 26% in the mechanical and electrical industries in 2000) combined with low commodity prices made overall exports decrease by 17%. Imports declined by 15% in the same period.

Traditionally, cocoa and coffee have been Ivory Coast's principal exports. As exhibit 5 shows, in the last decade cocoa exports still accounted for more of 20% of total exports, offset by an increase in exports of manufactured products, which in 2000 accounted for 41% of total exports.

1.3 Development Aid

Official aid flows

Development aid to Ivory Coast was relatively constant in the mid-80s, rising annually to the mid-90s. The 1994 devaluation coincided, not autonomously, with the highest level of net ODF, (in constant 1999 US$) of US$1.6 billion (see exhibit 6). Prior to this, total public flows were around US$500 million in most years (constant 1999 US$), rising to US$1.2 billion in 1990 and falling back to US$300 million in 2000. In terms of aid intensity, total flows rose to over 20% of GDP in 1994 and have declined since then, accounting for 2.9% of GDP in 2000.

Per capita aid flows reached a high of over US$117 in 1994, declined to US$67.5 in 1996, and reached a low of US$22 in 2000 due to the momentary suspension of aid from major donors.

In the five-year period 1985-1989, bilateral aid was US$381.5 million, or 58.5% of total net ODF, compared to US$271 million for the multilateral organizations. At the end of the period, bilateral aid, based on a five-year average, was US$457.8 million (in constant 1999 USD) and multilateral aid was US$143.1 million, or 23.8%. France has been the dominant bilateral donor to Ivory Coast, accounting for 58% of total bilateral ODA in 1995-1999. The EU is also a major donor in Ivory Coast (see exhibits 7 & 8).

Major donors, including France[10], suspended disbursements on most of their programmes as a result of the uncovering of the fraud on EU budgetary assistance in 1998. The reneging by the authorities (following the December 1999 coup) on debt-service obligations vis-à-vis multilateral creditors, definitively suspended all funds from this source (IMF, 2001). The EU has gradually resumed its operations since 2001 and the IMF formally approved the US$366 million Poverty Reduction and Growth Facility[11] in March 2002, marking the return of full assistance from all major funding agencies.

Allocation of aid

There has been a shift on aid modalities over the last 10-15 years, going from non-governmental project-specific to programme-related aid, while budgetary assistance[12] budgetary management are back at the central stage.

Private Flows

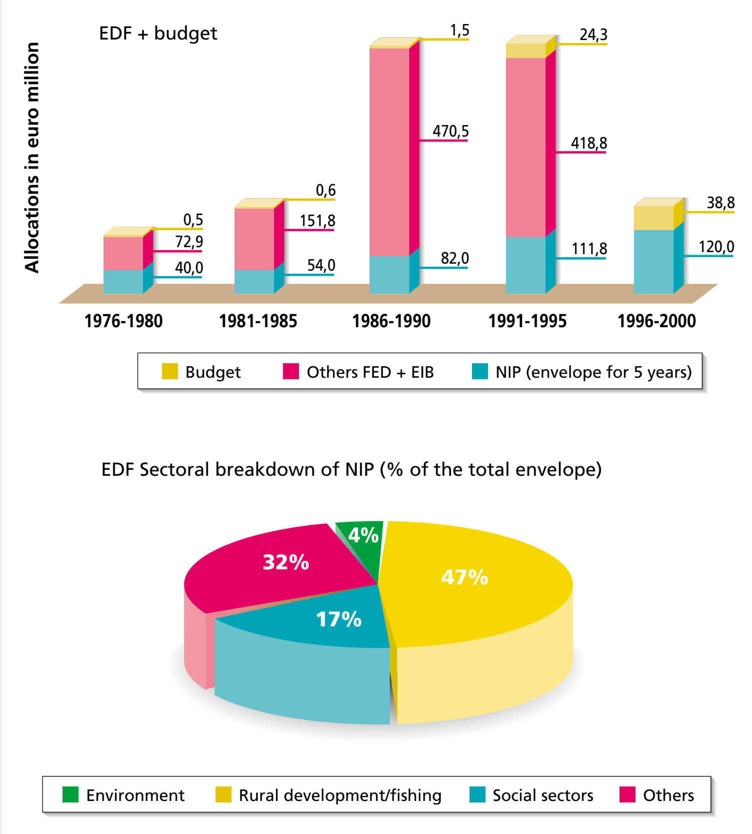
Net private capital flows have fluctuated over the last thirty years, following a downward trend since1980 (see exhibit 9). Net private capital flows averaged US$804 million annually in real terms during the 70s, compared with annual averages of US$472 million in the 80s and just US$75 million in the 90s. Available data indicate that bank and trade-related lending was the dominant driver of net private capital flows until 1980. Since then, and in particular from 1995, foreign direct investment has underpinned the modest rebound in private capital flows, accounting for US$444.9 million of net private capital flows in 1998, or 240%.

Since structural reforms began in 1981, Ivory Coast has attracted large volumes of aid from major donors under strong policy conditionalities, making it, as a result, "one of the most reformed countries on earth"[13]. Until the economic collapse of the early 80s Ivory Coast was a performing country, attracting private flows (the private vs. public ratio was 5.7 in 1980, see exhibit 10). Since then, Ivory Coast has become a clear example of an aid dependent country where conditionality has not achieved the expected results.

The role of donors in Ivory Coast has gone much beyond the mere provision of financing resources. Starting in 1981 with

EU AID TO IVORY COAST

Exhibit: 7



ODA COMMITMENTS TO IVORY COAST (ANNUAL AVERAGE IN CONSTANT 1996 US$ THOUSANDS)

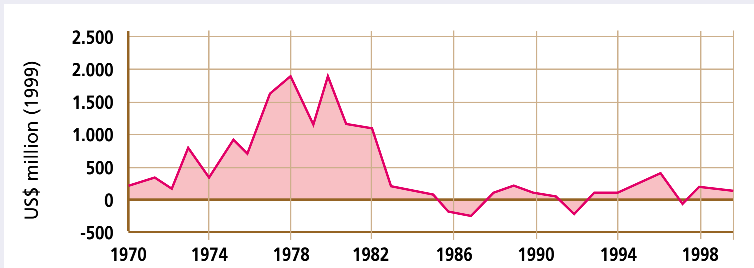
Exhibit: 8

Donors	1975-1979	1980-1984	1985-1989	1990-1993	1994-1997
Bilateral	**147.407**	**264.242**	**273.895**	**839.755**	**537.281**
France	47.575	96.342	111.093	348.263	201.932
EU Members	77.175	132.065	143.116	393.856	267.471
North America	22.657	24.220	9.434	56.651	22.477
Japan		11.615	10.252	40.985	45.401
Multilateral	**22.018**	**39.638**	**3.129**	**75.305**	**397.689**
IDA				39.647	317.142
European Union	22.018	39.638	479	25.357	68.844
AfDF/AfDB			2.650	10.301	11.703

Source: OECD, Credit Reporting System

NET PRIVATE CAPITAL FLOWS IN IVORY COAST

Exhibit: 9



Source: OECD - DAC Online Database

10 But not UNDP, that maintained its programmes throughout the 1998-2002 period.
11 This programme is based on the Government's Interim Poverty Reduction Strategy Paper (2002), which updates the 1997 National Programme for Poverty Reduction.
12 See for example World Bank, Assessing Aid, what works, what doesn't and why, 1998.
13 Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.

RATIO OF PRIVATE VERSUS OFFICIAL FLOWS

Exhibit: 10

	1970	1975	1980	1985	1990	1995	1999
Private/Official	0.6	2.2	5.7	0.09	0.06	0.25	0.18

Source: OECD DAC Online Database

IVORY COAST, WORLD BANK POLICY-BASED LOANS, 1980-98

Exhibit: 11

Loan	Type	US$ mn Commit.	US$ mn Disbursem.	Approval year
SAL I	SAL	150	150	1981
SAL II	SAL	250,7	250,7	1983
SAL III	SAL	250	250	1986
Agriculture	SAD	150	150	1989
Energy	SAD	100	100	1989
Water	SAD	80	80	1990
Banking	SAD	300	200	1991
Human Resources	SAD	335	235 [1]	1991
Competitiveness	SAD	150	100	1991
Human Resources	SAD	100	100	1994
Human Resources	SAD/5th	85	85	1994
Financial Sector	SAD	100	100	1994
Economic Recovery	SAL	100	100	1994
Regulatory Reform	SAL	50	50	1994
Economic Recovery	SAD/5th	77,9	77,9	1994
Agriculture Sector	SAD	150	150	1995
Agriculture Sector	SAD/5th	73,6	73,6	1995
Private Sector	SAD		180	1996
Private Sector	SAD/5th	54,6	54,6	1996
Debt Reduction	SAL	70	70	1997
Private Sector	SAD/5th	36,6	36,6	1997
Transport Sector	SAD	180	45 [2]	1998

Source: World Bank

Note: **SAL**= Structural Adjustament Loan/Credit. **SAD**= Sector Adjustament Credit. **SAD/5th**= Supplemental Credit with 5th dimension

1. - The US$ 100 million committed under the second and third tranches of the IBRD loan were canceled after the devaluation and restored as an IDA credit of US$ 100 million.

2.- Credit not yet closed which has an investment component equivalent to US$ 80 million.

the first structural adjustment loan/credit (SAL), donors have sought to directly influence economic policies and, increasingly so, institutions (see for example exhibit 11). A number of large donor projects have had significant institutional building components. For example, the important World Bank's 1991 PAGE – Projet d'Appui à la Gestion Economique – included components on budget reform, civil reform and reform of the judicial system. France has also consistently supported civil service reform and, to a more limited extent, reform of the judiciary. These efforts have generally covered all three elements of Institutional Infrastructure, namely the rules/regulatory framework, the structures of the institutions themselves and management issues (such as personnel qualifications).

The Ivory Coast case is special in that is has been characterized by a highly contentious relationship with the BWIs and, occasionally, the EU. The Ivorian leadership appears to have retained the belief that their own development model, the one that was implemented up until 1981, was fundamentally correct – being only temporarily derailed by adverse circumstances (namely weather and price shocks). This has also adversely influenced the impact of donors' efforts to improve Ivory Coast's Institutional Infrastructure. For example, the gradual reform and finally the disbanding of Caistab, an institution that played a critical role in the country's economic structure, was for decades a "bone of contention in the policy dialogue"[14] between Ivory Coast and the BWIs.

Aid and NGOs in Ivory Coast

NGOs in Ivory Coast play a critical role in addressing the weaknesses within the public services (e.g. micro-finance) and act as substitutes to formal democratic 'oversight institutions' (e.g. by putting pressure to increase transparency, and reduce corruption in the administration of public resources). There are 15 micro-finance NGOs in Ivory Coast involved in the provision of micro credit, mainly to the agriculture and trade sectors. Most of these NGOs have benefited from the support from either donors or foreign NGOs. The FENACOOPEC, the largest micro-finance NGO, was originally a governmental organisation and became an NGO with support from the World Bank, the Canadian Cooperation and France. Other significant finance NGOs have received assistance from the Canadian Cooperation and AFVP, a French NGO. But there are also locally developed, smaller and more recent NGOs in the area.

The benefits of cooperation with NGOs and particularly Civil Society Organisations (CSO) in the area of governance are well understood[15] in Ivory Coast. Donors have worked with NGOs to:

- Implement educational and training programmes centred on governance issues. For example, the African Development Bank's Governance and Capacity Building Project[16] includes the extensive use of NGOs for an educative programme on the law and the judiciary in poor and rural areas. The objective is to promote access to justice to the poor. Similarly, USAID has been working with specialised NGOs to offer educational programmes to voters about their rights as well as local democracy.
- Strengthen the NGO sector in governance-related areas. The UNDP's Good Governance Programme[17] includes a specific component for building capacity directed at the NGO sector. It comprises training and organisation advice, as well as direct financial support.

Although the benefits of using NGOs to enhance governance in the areas of justice and local democracy are likely to be strong, donors agree[18] that the local NGO/CSO scene is still in need of significant capacity building. In other areas, such as micro-finance or health, there is a longer tradition of cooperation with NGOs, and these appear to be better trained and structured to provide a valuable contribution.

1.4 Poverty reduction

A targeted national poverty alleviation strategy must be adopted by the government as top priority if Ivory

14 Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.
15 See Comprehensive legal and judicial development, Rudolf V. Van Puymbroeck ed., World Bank, 2000 for an application to justice.
16 BAD, Appui à la gouvernance et au renforcement des capacités, 2002.
17 Programme d'assistance pour une bonne gouvernance en Ivory Coast.
18 See UNDP, ONG actives et Structures de la Société Civile, 1999.

Coast's poverty situation is to be improved.

Rapid economic growth in the 60s and 70s led to a reduction of poverty, which could not be sustained during the period of stagnating output in the 80s and early 90s. The economic crisis after 1980 appears to have seriously worsened the situation of the country's poorest, with the proportion of poor households rising from 11% in 1985 to 32% in 1993 and 37% in 1995[19] (see exhibit 12).

In 1997, under pressure from the donor community, the country adopted a National Programme for Poverty Reduction, with measures targeted at improving school enrolment and literacy, basic health care, women's participation in development activities and birth control. However, this plan was not effectively implemented as a result of the break up of relations with donors over the period 1999-2002.

There are indications that the economic upturn after the 1994 devaluation has started to show positive results. Regarding social indicators, the data in exhibit 13 show that in 2000 these improved considerably after a period of deterioration in the second half of the 90s. Infant mortality rate per 1000 live births has decreased more than 3.3% from 1995 to 2000, achieving important progress. Life expectancy has also increased in 2000 following a four-year decline, reaching 54 years in 2000, higher than the average in Sub-Saharan countries as a whole.

POVERTY INCIDENCE, 1985-95 (%)

Exhibit: 12

	1985	1993	1995
Total	11.1	32.3	36.8
Abidjan	0.7	4.8	20.2
Other towns	8.0	31.3	28.6
East Forest	15.2	37.3	41.0
Savannah	25.9	48.5	49.4
West Forest	1.6	35.6	50.1

Source: World Bank Poverty Assessment Report, 1997

INDICATORS OF SOCIAL DEVELOPMENT

Exhibit: 13

	1995	1997	1999	2000
Infant mortality rate (per 1,000)	104	112	111	88
Life expectancy at birth (in years)	48	47	46	54
Primary school enrolment rate (in %)	69	n.a.	n.a.	71
Secondary school enrolment rate (in %)	23	25	n.a.	n.a.
Adult illiteracy rate (in %)	60	57	54	57

Source: World Bank Development Indicators

COMPARATIVE PERFORMANCE, 2000

Exhibit: 14

	Ivory Coast	Sub-Saharan countries	LDCs
Population (million)	16	659	2,459
GNI (Atlas method, US$ billion)	9.6	313	1,003
GNI per capita (atlas, US$)	600	480	420
Poverty (% population below national poverty line)	n.a.	n.a.	n.a.
Urban population (% of total)	51	34	32
Infant mortality rate (per 1,000)	88	92	77
Life expectancy (years)	54	47	59
Access to improve water source (% of population)	63	55	76
Adult illiteracy rate (% of population)	57	38	38
Gross primary enrolment (% school age population)	71	78	96

Source: World Bank

Ivory Coast relative performance compared with similar LDCs (2000)

Most Social indicators of development in Ivory Coast are slightly better than those for the region but are worse than the low-income countries as a whole (see exhibit 14). For example, life expectancy and access to safe water are much better in Ivory Coast than in the Sub-Saharan region. It seems that Ivory Coast is currently behind in education related social indicators; primary school enrolment is also below the average when compared with the Sub-Saharan and LDC countries in 2000 as with adult illiteracy.

2. INSTITUTIONAL INFRASTRUCTURE

2.1 Political system
(Overall rating 2)

2.1.1 The Rules

The most recent constitution was passed by referendum in July 2000. Based on a strong presidential regime, it provides for an economic and social council and guarantees the independence of the judiciary. The president is elected by a universal vote for a five-year term, which is renewable once. The president appoints a prime minister to co-ordinate the government. A unicameral parliament, the National Assembly (Assemblée nationale) is also elected by universal suffrage every five years.

Some aspects of the constitution – which was adopted during the recent military intermezzo (albeit by referendum) – have been criticized. In particular, the president is required not to have held any other nationality except Ivorian and his parents must be Ivorian citizens. Other aspects have been nevertheless interpreted as bringing more protection to human rights. Such is for example the abolition of the death penalty. The global assessment by political and human rights observers[20] is that the 2000 constitution is a significant improvement over the first 1960 text, as it provides a clearer and stronger framework to protect liberties, human rights and the rule of law.

Budget execution

Following the EU funds incident, the government adopted in late 1998 the Decree n°98-716, thereby providing a new regulatory framework for budget execution. The main thrust of the reform

19 World Bank.
20 UN, Rapport de la Commission d'enquête internationale pour la Ivory Coast, 2001.

was to introduce a sole, centralised disbursement mechanism[21] for budget execution, whereas in the past no systematic ex ante controls were made centrally prior to disbursements – resulting in an accumulation of committed spending for which payment orders had not been used (Dépenses engagées non ordonnancées, DENO).

2.1.2 The Structure

Party politics

The first multiparty elections took place in 1990 after 30 years of one-party rule by President Félix Houphouet-Boigny and his Democratic Party (PDCI). Mr Houphouet-Boigny was re-elected for five years – amid accusations of vote rigging – but died in 1993. His successor, former national assembly president Henri Konan Bédié, was confirmed in the 1995 elections with 95% of votes, after introducing an electoral law banning any candidate who was not pure Ivorian by birth or who had lived abroad in the five years before the election.

Mr Bédié strengthened his position in 1998 by increasing the residence qualification for candidates to 10 consecutive years. However, he was deposed in December 1999 by a military insurrection led by General Robert Guei. Faced with growing international pressure, which included the suppression of aid from lead donors, Mr Guei promised elections, which were held in October 2000. Laurent Gbagbo and his Ivorian Popular Front (FPI) won, making Mr Gbagbo President in the country's first democratic transfer of power, ten years after the introduction of a multi-party system. Mr Gbagbo scored 59% of the vote but, because of the Supreme Court's rejection of the candidates of the Republican rally (RDR) and the PDCI and their call for a boycott, this represented a low turnout of 37%. However, his legitimacy was strengthened when a popular uprising suppressed an attempt by Guei to remain in power.

Political disturbances since 1999 have seriously affected Ivory Coast's international credibility and weigh on the country's economic performance. The deteriorated social situation became explosive against a backdrop of ethnic and religious instability that had been much exploited during Bédié's rule. This produced rioting at the October 2000 presidential elections and the parliamentary elections two months later. The last attempted coup, in January 2001, highlighted Gbagbo's main task, to bring about national reconciliation. The peaceful local elections in March 2001, helped by the return of the RDR to the electoral process, were a big first step towards this and eventually led to the resumption of foreign aid.

Government

Budget execution is centralized and supervised by the Direction générale du Budget et des Finances, under the Ministry of Finance. The Minister of Finance has sole responsibility (ordonnateur unique) for budget outlays. He distributes spending limits to the following delegated ordonnateurs: in each central ministry, a DAAF; the Directeur de la Solde for public servants' salaries; The director of Treasury for debt service. The important point is that all ordonnateurs are linked into the SIGFIP and that the system will not allow expenditures without adequate credits. To date, this system SIGFIP has not been extended to the decentralised administrations/spending units in the provinces, but it is the intention of the government to do so.

2.1.3 Management

After the embezzlement of EU budgetary aid in 1998, improved transparency of the budgetary procedures, particularly budget execution, became a major condition for the resumption of foreign aid – and correctly remains very high on the donors' agenda.

Adequate budgetary procedures are clearly central to transparent aid management in Ivory Coast, all the more so as major donors have decidedly moved away from traditional, project-based assistance – which generally did not use the national budgetary mechanism for disbursement – toward budgetary aid[22]. For example, in 1998 France channelled about 62% of its assistance through the Ivory Coast budget. The EU used budgetary assistance[23] for some 88% of its assistance over the period 1991-96. Interestingly, it should be stressed that donors have not altered this trend after the misuse of EU budgetary assistance in 1998. On the contrary, France plans to raise the proportion of budgetary assistance to 80% in 2002 and the EU will maintain its extensive use of budgetary mechanisms.

In addition, in order to improve the safety and transparency of budget execution, the government has reformed the handling of non-budgetary foreign assistance. A clear and unique line of responsibility has been created in the fund disbursement process. Whereas in the past project funds were managed by project managers themselves, the government now insists that the fund manager should be the Comptable unique de la dette publique (CUDP), under the Ministry of Finance. In practice, this implies that for each assistance project a bank account is opened on the books of the BCEAO by the CUDP. The funds are disbursed to this bank account by the respective donor and are then managed by the CUDP. The advantage of this mechanism is to allow for immediate consolidation of all project disbursements. In the past, the government was only informed of those on an ex post basis, and often with considerable delays. However, this system does not seem to apply to grant-based assistance, such as the National Indicative Programmes of the EU.

It is too early to assess the impact of these changes on the quality of public funds management. In a 1999 protocol with the government, the EU listed the tasks that needed to be undertaken by the government to address transparency issues (the "correctives measures")[24]. These include:

(i) Setting up a Public Expenditures Review Unit;
(ii) Strengthening of the DAAF offices within the Direction générale du budget, introducing the SIGFIP[25] and budget monitoring in Municipalities;
(iii) Thoroughly revising the Code des Marchés and Publics and strengthening the Direction des marchés publics;
(iv) Strengthening the Inspection générale des finances, with the recruitment of 30 additional Inspecteurs des finances;
(v) Revising the legal framework of the Cour des comptes, with significant scaling up of the resources allocated to the Cour des Comptes, including by setting up an audit unit.

As can be seen from this list (of which only the main points are reported), only a fraction of these issues have been addressed to date. Indeed, if recent history is any guide, the scale of the 1998 fraud[26] suggests that transparency problems are likely to run deep. In short, much remains to be done to improve governance in this crucial area. This is not

21 This new rule includes (i) requiring that all expenditure be effected through SIGFIP, the new computerized system for budget preparation and execution, introduced jointly with the reform; (ii) limiting advances and ensuring the prompt regularization of those that are made; (iii) rationalizing government procurement costs; and (iv) giving the Ministry of Economy and Finance sole authority over the designation and supervision of the directors of administrative and financial affairs (DAAFs—Directeurs des affaires administratives et financières).

22 The shift towards budgetary aid also helped streamlining conditionalities across donors. As aid funds are channelled through the budget, they automatically support one unique set of policy measures, that is, the Government Programme. All EU/World Bank/IFM conditionalities are now based on the Interim Poverty Reduction Strategy Paper.

23 Stabex Funds and Structural Adjustment Facility.

24 In addition to other, often poverty-oriented conditionalities based on the Interim Poverty Reduction Strategy Paper.

25 The SIGFIP has now been introduced.

26 28 million.

an encouraging finding after more than 20 years of donor-sponsored structural reforms and institutional strengthening.

2.2 Legal Framework *(Overall rating 1)*

2.2.1 The Rules

The Constitution provides for an independent judiciary; however, in practice the judiciary is subject to executive branch and other outside influences[27].

Although the judiciary is independent in ordinary criminal cases, it follows the lead of the executive in national security or politically sensitive cases[28]. However, observers are generally critical of the quality and independence of the judiciary. In a Human rights practices report from the US Department of State[29] some examples are stated: 1) The presumption of innocence and the right of defendants to be present at their trials often are not observed and 2) Defendants accused of felonies or capital crimes have the right to legal counsel, and the judicial system provides for court-appointed attorneys; however, no free legal assistance is available.

On the commercial side, the Cour d´Arbitrage de Côte d'Ivoire (CACI) was established in 1997 with support from the World Bank to offer a means of conciliation and arbitration to businesses for the settlement of business disputes. The CACI operates within the legal framework of OHADA's Uniform Act on Arbitration. It provides a quick, cost-effective alternative to the clogged and supposedly corrupt Ivorian judicial system.

After a normal inception period[30], the CACI is beginning to handle relatively important cases. For instance, one current case in the insurance sector involves a settlement of approximately 6 million. It is currently handling three cases and foresees a growing number of cases for 2002. As the parties for each individual case appoint arbitrators, the CACI only needs limited permanent resources.

2.2.2 The Structure

The formal judicial system is headed by a Supreme Court and includes the Court of Appeal and lower courts. In rural areas, traditional institutions often administer justice at the village level, handling domestic disputes and minor land issues in accordance with customary law. Dispute resolution is by extended debate, with no known instance of resort to physical punishment.

The Cour d´Arbitrage de Côte d'Ivoire comprises of the following bodies: 1) A Board of Executives of 21 members (businessmen, lawyers, persons qualified in the field of Commercial Arbitration), presided by the President of the CACI; 2) An Arbitration Committee of three permanent members and three temporary members; 3) An Administrative office presided by the President of the CACI and represented by the Secretary-General. It includes the services of the secretariat, the treasury and documentation.

2.2.3 Management

Due to the lack of commitment from donors and local government, Ivory Coast has not been successful in implementing reforms in the judiciary. In the early 90s, the consensus among bilateral donors and the government was that the judicial system was weak, comprising:

- An antiquated legal code – laws were complex and deficient in areas such as contracts and credit, corporate financial and accounting regulations and bankruptcy and liquidation[31].
- Inadequate resources – the budget at the Ministry of Justice accounted for less than 2% of the overall state budget in 1990, most of which covered salary costs[32].
- Inefficient and inequitable funding – access to the courts was expensive and the procedures were onerous. Corruption was said to be widespread, aided by the fact that judgments were not required to be published and judges frequently ruled without stating the grounds for these rulings. Moreover, judges were inadequately trained in specialist areas.
- Lack of transparency – in procedures that led to inconsistencies in the treatment of claimants. Furthermore, the uneven treatment of private sector agents adversely affected business confidence.

The reforms undertaken by the government – with active support from key donors – have had a twin focus: reducing legal impediments in the labour market and reforming the overall judicial system to meet the needs of a modern market economy. General judicial reform in Ivory Coast began in the early 90s. The World Bank prepared a joint project with the Coopération Française – PAGE – in 1991 and both organizations worked together throughout most of the 90s on legal and judicial reform. Towards the end of the decade the following initiatives to improve the judiciary management were launched:

- Provision of training courses and recruitment of skilled personnel. Between 1995 and 1997, 50 judges were hired each year and judges, clerks and other staff benefited from 2,300 training days in 75 courses
- Establishment of the Central Legal Archives Service (Service Central des Archives Judiciaires)
- Effective establishment of CACI, the successor of the Abidjan Arbitration Court

However, evaluations[33] suggest that much remains to be done:

- There is a lack of a clear role as well as infective procedures and archaic working conditions for the clerks. The government has failed to reorganize the office of the clerks, held by many to be the most significant barrier to judicial reform.
- The main source of revenue for the judicial system, the fees and fines collected by the court[34], was removed but no substitute source of income has been created. The abolition of this fee was part of the conditionality of the 1991 Financial Sector Adjustment Credit from the World Bank and was effected by law in 1992. However, it returned to the books when the revenues had fallen by 90% in 1993 and remains on the books today.
- The failure to update technology in the greffes and elsewhere in the judicial structure is regarded by observers as a failure[35]. Most of the stock of computers is unused.
- Lack of appropriate knowledge management. The development since 1995 of the national documentation system took many years and has had trouble in finding financing.

The most fundamental effort – to sanitize the fee system and improve the operations of the clerk – "led nowhere"[36]. Even some clear achievements of the reform program

27 The new 2000 Constitution, although sound in this respect, is unlikely to have any significant impact on the way institutions function in practice. The former 1960 constitution already spelled out the independence of the judiciary.
28 US Department of State, Côte d'Ivoire human rights practices, 1995.
29 US Department of State, Côte d'Ivoire human rights practices, 1995.
30 Contracts first need to include a CACI arbitration clause and, second, disagreements between parties needs to arise before the CACI is effectively called upon.
31 This particular area was tackled under OHADA (see section below).
32 There was a shortage of courts – only 6 of the 10 first-level courts were in operation and 26 court sections out of 39. There were 253 judges for the entire population (14 million). The greffiers (clerks of court) were poorly trained, with less than 10% having post-secondary education.
33 Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.
34 The main source of revenue, the droit proportionnel d'enregistrement has no real purpose. This is a registration fee (5% of the amount owed) that the creditor must pay to secure a fixed date for the final court decision, despite the fact that the date is announced in other ways. If the creditor does not pay the tax, the court award will not be registered and the s/he cannot receive the implementing document (the gosse) necessary to collect what is owed
35 Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.
36 Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.

may have generated only limited impact. For example, some Ivorian lawyers criticize the training programme on the grounds that it provided specialized training (chiefly in business law) to judges who are unspecialised and mobile.

A number of reasons have been put forward as to why judicial reform has had limited impact on Ivory Coast. First, it is recognised that institutional reform in the judicial system is difficult per se -- as confirmed by many international publications[37]. Second, donors have been half-hearted in their commitment. French aid was limited and its main beneficiary was OHADA (see section below) rather than the national judicial system. Judicial reform was part of multi component (World Bank) projects, making it difficult to manage. The PAGE had components on budget reform (as noted above), civil service reform, and privatisation. Questions have also been raised by World Bank evaluators about the competency of the World Bank staff in this area.

Finally, the government's commitment has also been half-hearted, reflecting difficulties over the general public service reform. One important argument that has been put forward to explain the failure is that the reform of the judiciary has in fact run into general public service problems – first and foremost regarding pay and personnel management issues. Without an adequate, general reform of personnel management in the civil service, civil servants have faced few incentives to actually implement reform.

However, one outcome of this effort can arguably be spared this overall negative evaluation: the belated[38], but effective, establishment of the CACI. Possible factors explaining this relative success are that the CACI project was (i) modest in scope; (ii) not dependant on the outcome of reforms in the general judicial system – indeed the CACI provides an alternative to it in the area of business law.

2.3 Financial System *(Overall rating 4)*

2.3.1 The Rules

The Ivorian financial sector is governed by UEMOA's[39] Banking Law of 1990[40]. This law, a standard and up-to-date text, provides a definition of banks and financial institutions, and of the credit and investment activities conducted by the latter. It specifies the conditions of entry and of exercise of the banking sector, and determines the obligations that must be met by banks and financial institutions in the execution of their operations. The Banking Law defines the scope of the control exerted by the BCEAO's Banking Commission and spells out the rules governing UEMOA and the sanctions applicable in case these rules are not respected. This regulatory framework is acknowledged by most observers to comply with generally accepted international standards, particularly with regards to prudential rules. For example, the latter were updated in 2000 to adjust to new international standards.

Since 1996, with active support from the ILO and the BCEAO, the government has promoted micro finance organisations. A law was adopted in 1996[41] to regulate and provide specific fiscal benefit to NGOs working in the micro-finance area.

The BCEAO, a regional multilateral organisation, is responsible for the issuing of currency, monetary policy and the organisation and supervision of banking activities. At national level, a National Credit Committee assesses the amount required to finance the activity of the State and makes a proposal to the Board of Directors on the amount of domestic credit that should be granted and on the level of assistance that the Central Bank should provide to the banks and the Treasury.

2.3.2 The Structure

The Ivorian financial sector is dominated by the banking system, comprising 16 commercial banks[42]. The sector also includes seven non-bank financial institutions and a wide range of micro credit and small-scale credit institutions also provide financial services to rural communities and micro-enterprises.

The BCEAO is subjected to the overall direction and control of the Council of Ministers of the UEMOA, while a Governor, Board of Directors and a National Credit Committee govern the Central Bank. The Governor supervises the execution of the decisions of the Council of Ministers and the Board of Directors, which he chairs. He is assisted by two Deputy Governors appointed by the Board of Directors. He manages the foreign assets of the Union, while also being responsible for the organisation of the services of BCEAO and other activities.

The National Credit Committee is chaired by the Minister of Finance and comprises the two representatives of the State in the board of directors, four members designated by the government of the country concerned and one representative of France.

The banking system is complemented by the BRVM (Bourse Régionale des Valeurs Mobilières) regional stock exchange, established in 1998 as the successor of the Abidjan Stock Exchange. During the same time, the UEMOA countries established a regional securities regulatory body, the Regional Council for Savings and Investment. World Bank's IFC provided significant strategic guidance in the establishment of the BRVM, particularly by formulating a legal framework for the securities market[43].

2.3.3 Management

The overall favourable regulatory and institutional environment together with BCEAO's strong leadership have contributed to increased efficiency of the Ivorian financial institutions.

Financial reforms

The banking sector of Ivory Coast was significantly strengthened in the early 90s in the context of a vast financial sector restructuring effort with intense donor support. That included, inter alia, the liquidation of several banks, the settlement of government arrears and the recapitalisation of banks. In addition, the sector was also thoroughly liberalised, with the suppression of directed credit, the de-regulation of interest rates and the facilitation of market entry. This programme was carried out mainly under the leadership of the BWI[44]. These reforms were clearly, and fortunately, enhanced by the 1994 devaluation, which triggered a return of flight capital. The devaluation is seen an important factor in the restoration of the liquidity of Ivorian banks.

The BCEAO has provided UEMOA countries with efficient services[45]. It is considered to be appropriately staffed (3,672 as of December 2000[46]) compared to other banking institutions. For example, the European Central Bank has a staff of about 1,100 but the European Central Bank System also comprises national central banks, of which, for example, the Banque de France alone has a staff of about 14,000.

37 See Aid and reform in Ivory Coast, in "Aid and reform in Africa", World Bank, 2000.
38 It was only established in 1997
39 West African Economic and Monetary Union, comprising: Bénin, Burkina Faso, Ivory Coast, Guinea-Bissau, Mali, Niger, Sénégal and Togo.
40 See www.bceao.int.
41 Loi n°96-562 portant réglementation des institutions mutualistes ou coopératives d'épargne et de crédit.
42 One of which (Standard Chartered) entered the market in 2001.
43 IFC, Annual Report, 1997.
44 The World Bank provided two large financing packages for Ivory Coast's financial sector reform.
45 See IMF, Staff Report for 2001 Article IV Consultation and Staff-monitored programme (2001),Ivory Coast: Selected Issues and Statistical Appendix (2000).
46 BCEAO, Rapport annuel, 2000.

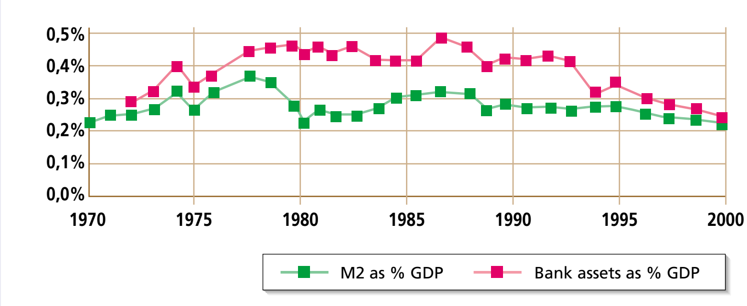
The good quality of the regulatory framework and the BCEAO together with BCEAO's close relations with the French Treasury owe to the considerable assistance provided by donors in the sector. As a consequence of its role as the official guarantor of the CFA's fixed parity, France has taken an active interest in ensuring that adequate banking standards and supervision methods were implemented in the CFA zone.

Still, the banking sector is facing some weakness:

- Banks are not fully playing their role of funding intermediation. Bank deposits have declined in the past decade due to the political turmoil and continuing economic weakness. The ratio of commercial bank assets to GDP increased from 28% in 1972 to a high of 47% in 1988, but has deteriorated since then (see exhibit 15), falling to 26% in 2000.
- The Limited intermediation capacity of the banking system is causing a deterioration of the overall quality of banks' loan portfolio. The stock of non-performing loans (before provisions) amounted to CFA franc 262 billion at end March 2001, equivalent to 22% of overall claims and 4% of GDP. Finally, as of December 2000, seven banks failed to maintain the 8% risk-adjusted capital adequacy ratio[47], suggesting that not all-systemic risk has been suppressed during the reforms of the 90s, which again tends to hamper the funding capacity of banks. Granted, the new prudential rules were adopted only in 2000 and the BCEAO has been pursuing the attainment of the capital adequacy criterion for all banks since them. The number of banks failing the test is reportedly lower in 2002.
- Ivory Coast lacks an adequate market structure. The banking sector remains concentrated, with the four biggest banks accounting for some 85% of all deposits and loans. In part, this can be explained by a tradition of collusive behaviour (once entirely legal) that is likely to have strongly influenced today's market structure. It was only in 1993 that the then perfectly official "Protocole Interbancaire" was rendered illegal and suppressed. This protocol was a cartel agreement between banks, setting, inter alia, common interest rates and other financing conditions.
- No appropriate investment products adapted to client needs. Banks, particularly the largest ones, massively concentrate their loans on short-term financing for the cocoa/coffee campaign. The BCEAO reports that these crops typically mobilise about 65% of all banking facilities, the balance being allocated to industry (about 30%) and to agriculture (about 5%). With nominal interest rates currently at 20% per year[48], the cocoa/coffee markets therefore provide a low-risk, profitable outlay for bank loans.
- A lack of interest of most banks to provide credits, particularly with long maturities, to small-scale enterprises. Private sector observers[49] representatives emphasise the difficulties of micro-enterprises, let alone informal enterprises, to gain access to formal credit. An interesting alternative could be provided by the many micro-finance schemes that have developed in recent years.

FINANCIAL DEPTH IN IVORY COAST

Exhibit: 15



Source: Compiled from International Financial Statistics, IMF

Micro-finance institutions, in particular NGOs, are complementing bank weakness in the micro-finance area:

- They offer a broader reach to the rural community in a country where 49% of its population is rural. The total number of branches was 184 in 1999, comparable with the 169 branches in the banking system. In terms of credit volume, micro-finance represented about 40 million in 1999 – compared with 1.6 billion for the banks. Most regions are covered by the micro-finance network, although the Western and Eastern regions have a much weaker branch density coverage.
- The interest rates on micro-finance loans in 1999 ranged from 5% to 20%, whereas the average interest rate on loans from the banks was 20%. Repayment rates were above 95% for six NGOs, and above 90% for nine of them. The number of beneficiaries stood at 296,000 as of December 1999.
- Among the factors explaining this impact is the fact that a community-based approach inherently makes it possible to circumvent the information asymmetries faced by banks. For example, group loans and peer monitoring (two schemes typical of micro finance, extensively used in Ivory Coast) facilitates the extension of credit to the poor, who lack the collateral normally required by formal credit institutions in the face of asymmetric information—as well as moral hazard.

The contribution of micro-finance to poverty reduction in Ivory Coast is considered to be significant[50] and the extension of the network is now being contemplated by the government and donors[51].

However, it must be stressed that the BCEAO is fully aware of these issues and their implications. Since 1990, one important policy objective of the BCEAO has been to foster competition in the banking sector. This is reflected for example in the Banking Law, which establishes transparent rules under which new banks can enter the UEMOA market. In 2000, market entry was further simplified by the creation of a unique banking license for all of UEMOA countries. As noted, one recent satisfactory development was the entry of one major international player, Standard Chartered. Lastly, the development of the banking sector -- and the development of sound competition in the banking sector – naturally depends on the general evolution of the economy, not only on the regulatory and institutional environment.

The stock segment of the BRVM, with a capitalisation of 1.1 billion[52] and only

47 UEMOA, Commission Bancaire, Rapport annuel, 2000.
48 The inflation rate in 2001was 4.4%.
49 See Ministère de l'industrie et de la Promotion du secteur privé/UNIDO, Programme cadre pour le développement du secteur privé, Environnement/Forces et faiblesses, 2002.
50 See BCEAO/ILO, Banque de données sur les systèmes financiers décentralisés, 1999.
51 Interim Poverty Reduction Strategy Paper, 2002.
52 As of 17 April 2002 (www.brvm.org).

38 stocks currently listed for all of UEMOA, provides only a limited contribution to the financing of the UEMOA economy, and in particular of that of Ivory Coast. Performance to date has been hampered by the lack of liquidity of most stocks. Only very few stocks (out of the 38) are typically traded on a daily basis[53]. Liquidity could improve as new listings come on stream – but this is dependent on further privatisations in the region. Lastly, the bond segment of the BRVM is even thinner. Capitalisation in that market is a mere 0.17 billion[54].

2.4 Corporate Governance *(Overall rating 3)*

2.4.1 The Rules

Corporate governance is regulated at the regional level, specifically within the OHADA organisation. Ivory Coast signed the OHADA treaty in 1993 with 14 other francophone African countries[55] to adopt a uniform system of business laws covering general commercial codes, company law, bankruptcy, accounting rules and various legal procedures. In 1996 and 1997, six uniform acts were adopted – general commercial law, company law, security, simplified enforcement procedures, bankruptcy and arbitration.

The goal of OHADA is to ensure a secure and predictable legal environment for businesses through the adoption of uniform acts[56]. The contribution of OHADA to legal security is particularly evident in three critical areas: the status of businesses, stronger guarantee for creditors, and the relevance of the collective procedures for discharging liabilities to the problems faced by businesses. In all three areas, OHADA countries are now equipped with modern laws, well adapted to the development of a market economy. The OHADA's uniform company law was all the more commendable considering that Ivory Coast had been operating under outdated provisions of the civil code and the laws of July 24, 1867 and March 7, 1925. Another particularly welcome development is that sales of goods and services between business professionals are now carefully regulated, from the development of the sales contract to its execution.

A parallel UEMOA-sponsored development is a unified accounting system, the Système Comptable Africain (SYSCOA), which came into force in January 1998. The SYSCOA is now being integrated under OHADA rules. The SYSCOA is derived from the French Plan Comptable of 1986 and provides an up-to-date and unified accounting environment for all businesses in the region.

2.4.2 The Structure

The OHADA is comprised of four institutions: the Council of Ministers (its supreme authority), the Permanent Secretariat, the Common Court of Justice and Arbitration (CCJA) and the Regional School for the Advanced Training of Judges and Judicial Personnel.

The Uniform acts were prepared by the Permanent Secretariat of the OHADA in consultation with the governments of the states that were parties to the Treaty establishing OHADA. The council of Ministers discussed and adopted the acts on the advice of the CCJA. Interestingly, national parliaments are excluded from the proceedings for adopting uniform acts. The Council of Ministers has sole competence in this area. This has made it possible to avoid the drawbacks of indirect procedures that could lead to the adoption of conflicting legal texts that would be difficult to implement. The acts become effective immediately after they are published in the Official Gazette of the OHADA, without the need for additional regulatory legislation from the treaty party states. They are directly applicable and binding in all OHADA countries, notwithstanding any contradictory provisions in existing or future national laws.

2.4.3 Management

The supervision of corporate governance at a regional level (through the OHADA) has facilitated the reforms in Ivory Coast, which led to an improvement of the judicial and business environments. OHADA was created in response to the preoccupying judicial insecurity, correctly identified by governments of the region as major source of uncertainty, which was perceived as incompatible with the minimum level of predictability regarding legal issues that is necessary for economic activity. To some extent, the OHADA therefore addresses – albeit on a regional basis -- the same issues tackled by Ivory Coast's national reform of the judiciary[57]. This makes possible an interesting comparison between national versus regional approaches. OHADA has received extensive support from major donors, particularly from France and the EU.

OHADA has also sought to improve the judicial environment by developing a body of judges and judicial personnel capable of appropriately applying the uniform laws. Particularly, the CCJA was established to ensure the uniform application of the Treaty, its implementing regulations, and the uniform acts. The OHADA Treaty establishes that the CCJA has three functions: (i) Consultation – the Court is consulted and advises on uniform acts before they are adopted by the Council of Ministers; (ii) Litigation – the Court serves as the appellate judge in a court of cassation in place of national courts of cassation in all matters relating to harmonized business law; (iii) Arbitration – Pursuant to an arbitration clause or an arbitration agreement, anyone party to a contract[58] may submit a contractual dispute to the CCJA.

The mission found that Ivory Coast's private sector, including banks, considers OHADA's contribution a significant improvement of the business environment. For example, the Uniform Act Relating to Commercial Companies and Economic Interest Groups, Uniform Act Organising Securities, Uniform Act Organising Simplified Procedures and Measures of Execution are quoted as modernising and clarifying critical issues such as bankruptcy, corporate governance and debt recovery and, more generally, contract enforcement. The SYSCOA is an important step towards accounting transparency and therefore corporate governance.

Another example is provided by the Economic Interest Group (Groupe d'intérêt économique, GIE), a French-inspired OHADA legal innovation that provides a simple, quick and cheap alternative to cooperatives and associations as a legal form for micro enterprises and NGOs. In other OHADA countries[59], the GIE instrument has been an interesting addition, contributing towards bringing informal, micro enterprises in agriculture and urban services sectors into the formal sector, albeit in a very simplified manner.

Just like UEMOA and the BCEAO, this mechanism suggests that tackling basic and critical regulatory issues at cross-country level can bring important benefits to Ivory Coast.

53 www.brvm.org.
54 As of 17 April 2002 (www.brvm.org).
55 All UEMOA countries are members of the OHADA.
56 Uniform Act Relating to General Commercial Law (1997), Uniform Act Relating to Commercial Companies and Economic Interest Groups (1997), Uniform Act Organising Securities (1997), Uniform Act Organising Simplified Procedures and Measures of Execution (1998), Uniform Act organising Collective Proceedings for wiping off debts (1998), Uniform Act on Arbitration (1999). See www.ohada.com.
57 See section 1
58 Whether one of the parties is domiciled or has its habitual residence in a signatory state, or whether the contract is executed wholly or in part within the territory of one or several signatory states.
59 See IFC/FIAS, Sénégal: Parcours de l'investisseur, une réévaluation, 2002.

However, it is important to emphasise that the legal component of OHADA is far ahead of national judiciaries, including those of Ivory Coast, in terms of enforcement effectiveness. The weakness of Ivory Coast's national judiciary – as opposed to OHADA's legal and regulatory layer – is still a major obstacle for the economy to reap the benefits of OHADA's legal contribution. The ineffectiveness of the judiciary (see section 2.2) continues to severely affect corporate governance through the business judiciary, a part of the country's general judiciary (Tribunaux de commerce). As noted, arbitration could provide a valuable contribution towards better corporate governance, but this too has its limits. First and foremost this is because an arbitration decision needs an adequate judiciary in order to be fully enforceable[60].

But still, indications that governance is a major concern in Ivory Coast abound. Exhibit 16 reports a set of synthetic governance indicators, showing that Ivory Coast failed to improve its Government Effectiveness indicator, as well as a deterioration in Political Stability and Rule of Law. The percentile rank indicates the percentage of countries worldwide that rate below the selected country, here Ivory Coast, subject to a margin of error. Based on this measure, Ivory Coast has regressed across all indicators when comparing 2000/01 with 1997/98.

GOVERNANCE INDICATORS FOR IVORY COAST 1997/98 AND 2000/01[61]

Exhibit: 16

Governance Indicator	Year	Percentile Rank (0-100)	Estimate (-2.5 to + 2.5)	Standard Deviation	Number of surveys/ polls
Voice and Accountability	2000/01	12.6	-1.19	0.25	4
	1997/98	32.8	-0.57	0.25	4
Political Stability/No Violence	2000/01	16.0	-0.95	0.29	4
	1997/98	44.2	-0.14	0.27	5
Government Effectiveness	2000/01	23.8	-0.81	0.25	4
	1997/98	47.8	-0.18	0.24	5
Regulatory Quality	2000/01	33.1	-0.30	0.37	4
	1997/98	48.5	+0.15	0.29	5
Rule of Law	2000/01	35.3	-0.54	0.25	5
	1997/98	43.1	-0.33	0.25	6
Control of Corruption	2000/01	26.7	-0.71	0.26	4
	1997/98	57.1	-0.08	0.21	5

Source: Kaufmann, Kraay and Zoido (KKZ), 2002: Governance Matters II: Updated Governance Indicators for 2000-01

UEMOA'S TARIFFS (% OF CAF VALUE)

Exhibit:17

Position	Goods	Customs duties	Statistical tax	Solidarity tax
0	Basic and social goods	0	1	1
1	Raw materials, food stuff, capital goods, specific inputs	5	1	1
2	Inputs and semi-finished goods	10	1	1
3	Consumer goods	20	1	1

A possible cause of the low impact of some 20 years of adjustment on governance relates to the shift in aid modalities that took place over the last 10-15 years. Governance was previously not a central concern of donors in Ivory Coast (and indeed elsewhere) because, even though policy conditionalities were attached to aid programmes, most donors set up and used non-governmental project-specific implementation mechanisms for disbursements – not the budget[62]. As the transition from project-based aid to programmatic and budgetary assistance[63] has intensified in Ivory Coast – and is now coming of age – governance issues relating to budgetary management are back at the central stage. In this sense, the decision of donors to maintain a strong focus on budgetary aid even though this very mechanism was severely misused by the government is entirely adequate. It is only by using national institutions, not by short-circuiting them as in the former hands-on, project-based approach, that these can be vivified and eventually improved. At the very least, making use of a budgetary approach has the considerable merit of focusing donors' attention on some critical governance issues.

2.5 Trade and Competition *(Overall rating 2)*

This section concentrates on the regulation of competition in Ivory Coast. It excludes specialised markets such as the financial sector (see above) and mining, while nevertheless focusing on commerce, industry and oil products. Interestingly, this area is in sharp contrast with the regulation of the country's financial sector in that the regulatory framework is entirely national, not regional. This, combined with other factors, unfortunately appear to have been a significant cause of low performance. This important area had been slated for assistance from the French Co-operation in 1998[64], but that project quickly came to a halt following the 1999 suspension of aid.

2.5.1 The Rules

Ivory Coast's competition regulatory framework is the 1991 "Loi relative à la concurrence", fairly standard competition law. The main items are: (i) prices for goods and services should be freely determined through competition, except for a limited number of basic goods[65]; (ii) dumping is prohibited, (iii) there must be free market entry and (iv) de facto monopolies/oligopolies are restricted and may be subjected to price controls and/or de-concentration.

Trade regulation in Ivory Coast is another example of successful regional liberalization. Ivory Coast is a member of UEMOA, which in 1994 replaced and enhanced (with economic cooperation) the former UMOA (West Africa Monetary Union). One key achievement of UEMOA is the creation of a customs union, complete with a Tarif extérieur commun, TEC that applies to all imports to UEMOA countries and the suppression of customs duties on intra-UEMOA trade. Since January 2000, the maximum TEC rate is 22% of CAF value (see exhibit 17).

60 OHADA's Uniform Act on Arbitration provides the legal framework under which arbitration mechanisms that comply with its provisions (which is naturally the case of the CACI) produce decisions that have full legally binding force, meaning that they are fully enforceable through the judiciary – that, conversely, has no legal power to challenge them.
61 Based on 194 different measures drawn from 17 different sources of subjective governance data constructed by 15 different organizations, including international organizations, political and risk-rating agencies, think tanks and non-governmental organizations. Voice and accountability summarizes the ability of citizens to participate in the selection of governments and correlates this with the freedom of the media to report on the actions of those in power. Political stability underlies the belief that governance is compromised by sudden and abrupt changes in government. Government effectiveness refers to the inputs needed for good and effective government, while regulatory quality is a measure of the effectiveness of actual policy. Rule of law summarizes the success of a society in developing a fair and just society. The control of corruption cluster is a measure of the perception of corruption.
62 See for example IDC, Evaluation de l'aide de l'Union Européenne aux pays ACP, Etude de Pays n°3:Côte d'Ivoire, 1998 and OED, Côte d'Ivoire: Revue de l'aide de la Banque mondiale au Pays, 1999. One important exception is the IMF, which has always provided budgetary, non-targeted assistance to Ivory Coast.
63 See for example World Bank, Assessing Aid, what works, what doesn't and why, 1998.
64 Training was the main focus of the French assistance.
65 These goods are (i) water, electricity, telecommunications; (ii) gas; (iii) School books; (iv) basic foodstuff, including rice and wheat; (v) medicines.

2.5.2 The Structure

The law provides for the creation of two institutions:

- The Commission de la concurrence (the Commission for Competition, or CC); whose role is only consultative. It provides a qualified opinion to the Minister of Commerce, who then decides upon a course of action, still within the framework of the Loi relative à la concurrence. Its competency covers cases of illicit cartels/oligopoly, breach of free entry and dumping. It can be challenged ("saisi") by the Minister, by a private person (physical or moral) or by itself.
- The Direction de la concurrence (DC) within the Ministry of Commerce, whose principal role is to implement price controls for goods that are subject to them (refer to footnote 65).

One important feature of the institutional set-up is therefore the existence of two separate bodies. The CC has only limited administrative and human resources – and very limited effective power, being only a consultative body. It is comprised of nine non-permanent members, including magistrates, private sector representatives, an economics university professor and a law university professor. It also includes the DC, which formally represents the State. Only four civil servants permanently staff the CC, acting as "rapporteurs" of the cases brought before it.

The DC has a staff of 68, including support staff. Among these, 45 "price agents" are responsible for price controls and supported by two policemen. The CC also benefits from the support of ten regional directions of the Ministry of Commerce, comprising each a staff of 20[66]. Being entrusted with an official mission -- price control -- and with the corresponding judiciary power, the DC is much more active than the CC. It issues some 30 fines per weeks, collecting approximately 0.2 million.

2.5.3 Management

Plans for strengthening the competition regulation have been transferred to the regional level due to the lack of clear roles and effective procedures of both the CC and DC. The CC has lost all practical influence over the years. The number of cases actually submitted to the CC appears to have dramatically decreased in recent years. One of the most prominent cases concerned (imported) oil products, for which the CC was challenged by the State. The sanctions advised by the CC (principally a price cap) in this particular instance were approved and implemented by the State. Private sector representatives met by the mission repeatedly expressed a low degree of confidence in the effectiveness of this mechanism. Being both understaffed and deprived of any judiciary power, the CC does not seem in a position to make a valuable contribution to the regulation of competition.

Yet, both the training of the DC staff and the very purpose of this institution relate to an era of economic policy the government is endeavouring to leave behind, namely the direct monitoring and active intervention of the state on prices and factor allocation. Hence the paradoxical situation where the CC, whose purpose fits the market-based approach now favoured by the government, is in practice powerless, whereas the DC is indeed active while its role should normally be marginal in a market economy.

The government is well aware of these shortcomings and had intended to address them when the 1998 crisis broke out. Action included, in particular, endowing the CC with judiciary power. In the meantime, however, the OHADA has fully confirmed its potential as an effective instrument for providing an adequate regulatory framework in business and commercial law in the region. Plans for strengthening the competition regulation have thus been correctly transferred to the regional level. A drafting of a new legislation, within the OHADA legal framework, is under way, while a corresponding restructuring of national competition watchdogs into one single regional institution is being contemplated. This is all the more adequate as the UEMOA now includes a full customs area, transforming the zone into a single trade block.

Trade

It is generally accepted that UEMOA, which has received extensive support from donors (particularly the EU and France) has been effective in deepening the trade liberalization started in Ivory Coast under the World Bank's PASCO of 1991. In 1995, on the basis of 350 tariff positions, the weighted average tariff rate decreased to 29% from 37% in 1990. As noted (see exhibit 17), the maximum is now 22%.

3. CONCLUSIONS

Of the five areas examined in this report, three have experienced serious difficulties and show a low level of influence from aid on the quality of institutions (Political System, Legal Framework, Trade and Competition).

Of particular concern is the current state of governance in Ivory Coast. More than 20 years on, intense donor-imposed adjustment appears to have achieved little impact in terms of sanitizing central public funds management mechanisms and fighting against corruption, as evidenced by the large-scale 1998 fraud. Conversely, the low quality of the institutions in these sectors is likely to lessen any future impact of aid in Ivory Coast, and will therefore affect the capacity of the government and donors to achieve poverty reduction. In particular, with respect to the "Political System" area, issues of public funds management (particularly budget execution) have indeed become a major concern of donors, especially as the latter now channel an increasing portion of their assistance through national disbursement mechanisms.

These three areas share one common factor: they were purely national reform efforts (as opposed to regional). In at least two areas, judicial reform (especially) and the budget, global public service factors such as personnel/pay incentives appear to have had a significant role in the failure of reforms. Somewhat confirming this hypothesis, the few successes recorded in those areas have been carried outside the public service, like for example the CACI. To some extent, this finding can be viewed as relating to the concept of "management" (as opposed to rules/structures) emphasised in the Phase I report. Personnel/pay issues affect the whole public service, regardless of the specific regulatory framework or the organisation structure of individual administrations.

A second important factor has been the "substitution effect" that has stemmed from the array of donor-specific, parallel administrative units set up, on a project-by-project basis, to implement donor-funded projects or simply to manage project fund disbursement. As donors realised that such implementation mechanisms could severely inhibit the normal development of national institutions – and rendered meaningless the improvement of governance, including anti-corruption and national 'oversight' mechanisms -- these parallel units have been dramatically scaled down in favour of national budgetary procedures. Still, given the natural inertia of institutions, the legacy of this hands-on approach is likely to linger on, as evidenced by Ivory Coast's recent performance in terms of governance.

Conversely, the two areas that have managed to build significant institutional infrastructure are the Financial Sector and Corporate Governance. In both sectors, the fact that reforms and supervision have been carried out at supranational level has been a clear facilitator of success. The analysis above suggests that there are two main reasons for this. First, the regulatory/legal problems faced by West African countries are similar, as they all were once governed by French law, from which many national

66 Being delegations of the Ministry of Commerce, the Regional Directions are not full resources to the CC.

regulations were directly derived. There are clear economies of scale to be reaped by pooling the reform effort at a regional level. Second, and perhaps more importantly, earning the trust of the population and the private sector is key to the success of reforms, as comes out clearly from the both Ivory Coast's Financial Sector and Corporate Governance areas. A regional approach appears to strengthen the belief that reforms will effectively go through, not being impeded by national political considerations. This in turn has helped build private sector commitment and therefore facilitates effective implementation.

Finally, it can be argued that a common regional approach does not only facilitate reforms but also reinforces the economic benefits of regional trade and monetary integration. This is because it reduces the transaction costs across countries.

In the financial sector, cooperation with NGOs has resulted in better access to credit by the poor. The inherent community-based approach of micro-finance NGOs has made it possible to circumvent the information asymmetries typically faced by banks. For example, group loans and peer monitoring (two schemes extensively used in Ivory Coast) facilitate the extension of credit to the poor, who lack the collateral normally required by the formal credit system. It is interesting to note that the level of collateral required by banks and/or credit rationing (in Ivory Coast and elsewhere) are a function of the lack of legal safety of the business environment. In other words, in an environment fraught with information asymmetries and moral hazard, the less likely a borrower is to be legally punished in case of default, (fraudulent or not), the more likely he is to effectively default, and therefore the higher the collateral required by the bank. Community-based credit NGOs act as institutional substitutes: they provide a peer-driven mechanism to punish defaulters, which in turn reduces or even suppresses the need for collateral, thereby providing better access to credit by the poor.

In the area of governance, the potential of cooperation with NGOs is also likely to be strong, but it has not been used to the full in Ivory Coast – making it difficult to draw definite conclusions. Yet the argument that NGO/CSO pressure and educational services can be used to build up awareness and eventually demand for more transparency and governance is valid and potentially helpful in Ivory Coast, where governance issues are critical. To some extent, just like micro-finance NGOs, governance NGOs/CSOs can also be viewed as substitutes to formal democratic oversight institutions, putting pressure on leaders to administer public resources with greater transparency. This is especially true at the local/community level, but can also apply nationally, for example through nation-wide pressure groups, think-tanks, consumer group, etc.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[67]					
		1	**2**	**3**	**4**	**5**	**6**
Political System	Rules			X			
	Structure		X				
	Management[68]		X				
	Combined Rating		**X**				
Legal Framework	Rules		X				
	Structure	X					
	Management	X					
	Combined Rating	**X**					
Financial System	Rules				X		
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Corporate Governance	Rules				X		
	Structure			X			
	Management			X			
	Combined Rating			**X**			
Trade & Competition	Rules			X			
	Structure	X					
	Management	X					
	Combined Rating		**X**				
Overall Rating			**X** **2.5**				

67 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good
68 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures	X					
	Costs / Waste		X				
	Corruption	X					
	Combined Score		**X**				
Legal Framework	Objective Setting & Accountability	X					
	Quality of Personnel		X				
	Effective Decision Making	X					
	Efficiency of Procedures	X					
	Costs / Waste	X					
	Corruption	X					
	Combined Score	**X**					
Financial System	Objective Setting & Accountability				X		
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures				X		
	Costs / Waste				X		
	Corruption				X		
	Combined Score				**X**		
Corporate Governance	Objective Setting & Accountability			X			
	Quality of Personnel			X			
	Effective Decision Making				X		
	Efficiency of Procedures			X			
	Costs / Waste			X			
	Corruption				X		
	Combined Score			**X**			
Trade & Competition	Objective Setting & Accountability		X				
	Quality of Personnel	X					
	Effective Decision Making	X					
	Efficiency of Procedures	X					
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				

COUNTRY REPORT - MALAYSIA

TURNING RIPPLES INTO WAVES

THE SUCCESS STORY OF MALAYSIA'S ECONOMIC DEVELOPMENT

This report on Malaysia is one of 8 country reports undertaken to examine the overall question "what makes economic development successful?". It addresses three questions and each has a corresponding chapter.

The analysis is based on a one week visit to Malaysia with additional desk research. Considerable thanks are due to the numerous institutions and individuals who kindly made time available and provided their views and analysis of Malaysia's economic development (see appendix 1). Particular thanks are due to the Economic Planning Unit (EPU) at the Prime Minister's Office whose comprehensive and detailed data is widely used in this report. Extensive use was also made of the high-quality web-sites available for numerous official organisations and government ministries.

To comply with our overall terms of reference, this report focuses on; first, providing judgments on the institutional infrastructure which manages Malaysia's economic development process; and second, on the lessons which other countries can learn. In so doing, the report does not pretend to be an "in-depth macro-economic analysis" of the kind produced by international institutions and economic analysts. Nor does it give significant descriptive narrative or data summaries, all of which are readily available from numerous other high quality sources.

KEY QUESTIONS

Key question	Corresponding chapter
1. Has Malaysia been successful, and if so, in which areas?	1. Development performance
2. Has the management of economic development been good?	2. Institutional infrastructure
3. What can other countries learn from the Malaysian experience?	3. Lessons learnt

Executive summary: the story in brief

Malaysia achieved independence in 1957 and is a multi-racial society of around 23.5 million people with a democratic political system structured as a federation comprising thirteen states. Its initial years of independent economic development from 1957-1970 were characterized by a laissez-faire, export-orientated agricultural economy. Our analysis focuses on the period from 1970 to 2002, during which GNP per capita increased tenfold from US$ 368 in 1970 to around US$ 3,600 (estimate for 2002). During that period Malaysia truly "turned ripples into waves"[69].

In reply to the first question; "has Malaysia's development performance been successful?" the answer is yes. Malaysia has been overwhelmingly and impressively successful in its economic performance and there are at least four overall reasons for reaching this point of view (see chapter 1):

a) A broad selection of macro-economic indicators over 32 years shows generally strong to very strong performance, practically a "dream story" that any country would like to emulate, with GDP growth averaging around 7% p.a. for the period.
b) Strong socio-economic performance and poverty eradication was also achieved over these years with a current target of only 0.5% of the population classified as "absolutely poor" by the year 2005, which is in line with the national policy of "growth with equity".
c) An independent, largely self-financed and pragmatic development model has been followed which is tailored to the real needs of the country rather than representing a wholesale adoption of standard recipes tied to international (aid) finance.
d) A noticeable openness to improve further and face strong cyclical and structural challenges is apparent in many quarters which should set the stage for further innovation in the next decades of economic management.

A first reaction to this conclusion is obviously "why?" and "how?" Causality is one of the key debating points in economic management, so it is not easy to come up with an answer. Doubtless, one reason for the strong economic development performance is the attractive natural resource endowment Malaysia enjoys (i.e. rubber, tin, palm oil, timber, petroleum) as well as a strong human resource endowment (labour force skills etc). But that is not enough; so many countries have had resource endowments which have failed to drive the engine of economic development. Which brings us to the second question; "has the management of economic development been good?" In our view the answer to this question is also; yes. While acknowledging the causality arguments, it is precisely the high quality management of the economy which provides the main explanation for Malaysia's success story. It is not a matter of simply having natural and human resources, it is a matter of what you do with them. And here Malaysia has excelled; its institutional infrastructure provides one of the main explanations of its economic success. The key elements of this include (see chapter 2):

a) A democratic political system providing stable governments which are prepared to take tough decisions, and which use a high quality public administration in order to achieve effective implementation of its policies.
b) An unusually pragmatic, hands-on economic management process which is business-like and open, with a strong emphasis on communications and information, and which combines sophisticated planning techniques with an open economy market mechanism.
c) A financial sector which had acknowledged historic shortcomings but which is now being restructured swiftly and pragmatically, adopting many aspects of international best-practice.
d) A highly market-driven competition and trade structure at the domestic as well as international level, which has fuelled economic growth notwithstanding some subsidies and other distortions.
e) Strong recent emphasis on improved governance, which acknowledges past inadequacies and has tackled the issue in a thorough manner.
f) A legal system and judiciary which has not been an obstacle to the majority of commercial claims and has resolved them as efficiently as would be typical in other countries[70].

69 The phrase is borrowed from one of the National Information Technology Council's (NITC) publications. Although the NITC applied it in a technology context, it could equally describe Malaysia's overall economic development achievements.
70 The legal system was not examined in detail for this report, and the views are tentative and restricted to commercial law.

Which brings us to the third question; "what can other countries learn from the Malaysian experience?" Of course any prescriptive statements run the risk of being thrown out by other countries on the grounds that "it's all different here" and "we can't afford to do what they did" etc. This is partly true, but nevertheless there are some generic elements which, if introduced successfully, should make economic development performance better than it would otherwise have been. These all relate to improvement of the institutional infrastructure and essentially follow the six areas noted for Malaysia in question 2 above (see chapter 3):

- Improve the public administration's effectiveness and efficiency in policy implementation
- Adopt a hands-on economic management process which is tailored to economic and socio-cultural realities
- Restructure the financial sector in line with international benchmarks
- Insist that the full force of competition prevails overall[71] in the domestic and international trade sector
- Force the application of best-practice in governance techniques
- Ensure that the process of (commercial) dispute resolution in the courts is satisfactory

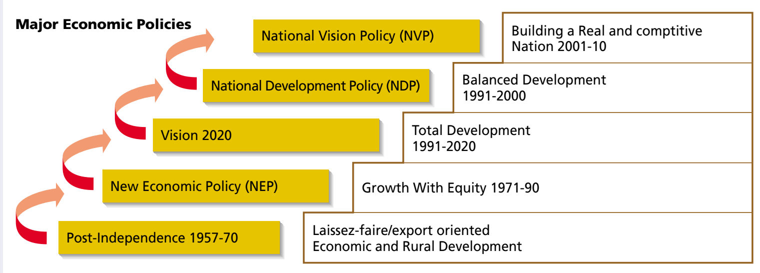
These six prescriptions have a "motherhood" ring about them, and no self-respecting government should deny that they are desirable and important. But the point is that Malaysia has demonstrated two things in relation to these six prescriptions; first, how you actually achieve them at the practical level, and second, how they are beneficial once you have them. And this is the heart of the argument; develop a well-managed institutional infrastructure and economic development will improve.

CRITERIA TO ASSESS DEVELOPMENT PERFORMANCE

Evaluation criteria	Analysis
1. Capacity to create wealth (i.e. macro/growth)	Section a) Macro-economic performance
2. Capacity to ensure equitable distribution of that wealth (i.e. socio-economic stability)	Section b) Poverty reduction strategies
3. Capacity to design policies and methods to sustain wealth creation (i.e. development model)	Section c) Development model
4. Capacity to react to challenges and criticism (i.e. adapt)	Section d) Response to challenges

ECONOMIC POLICIES AND INDUSTRIAL PHASES

Exhibit: 1



Industrial Phases in Malaysia

PHASE	Strategies	Policy	Industrial Emphasis
I	Import Substitution Industries (1956-70)	Industrial Pioneer Ordinance	Light Consumer goods Domestic market oriented
II	Export oriented Industries (1970-80)	Investment Promotion Act. 1960 Industrial Coordination Act. 1975	Export oriented Free-trade zones Exports of electronic goods and textiles
III	Import substitution (1970-80)	Heavy Industries	Consumer durables Capital and Intermediate goods
IV	Export oriented Industries (1986-2005)	Industrial Master Plan (1986-95) Investment Promotion Act, 1986 Second Industrial Plan (1996-2005)	Access to new markets Cluster-based industries Strengthen industrial linkages

Source: EPU

1. Development Performance

As stated in the introduction, this report does not contain an in-depth macro-economic analysis of the Malaysian economy. The purpose is more limited; taking the question "has Malaysia's development performance been successful, and if so, in which areas?" the answer will be judged on the basis of four evaluation criteria:

The line of argument with these evaluation criteria is simple. Development performance can only be considered good if it generates wealth, and if it does so on a sustainable basis (by inter alia maintaining social stability), and if it relates to a model and approach which forms a set of coherent inter-related policies, and if it can react and adapt to the changes which are omni-present in a global economy. Often economic development performance is largely judged by the first set of analyses in isolation i.e. macro-economic growth statistics. But in this report that is not considered enough; development performance will only be considered good if all four aspects are judged to be good. And for Malaysia that is precisely the conclusion:

- Section a) will cite data why more than 30 years of economic performance from 1970 onwards demonstrates an impressive record of wealth creation
- Section b) will show that poverty reduction has been a conscious and successful strategy from 1970
- Section c) will show that these achievements result from an independent and unusual model of development
- Section d) will review some criticisms as well as the development challenges ahead and the system's ability to adapt and deal with those

The conclusion drawn from these four analyses, in short, is that Malaysia's development performance has been overwhelmingly and impressively successful as it scores high on all four areas of development.

a) Macro-economic performance

Malaysia's macro-economic development is characterised by an open, mostly export-driven and FDI-led economy. Since independence, there were five major phases of economic planning which corresponded to several industrial strategies (see exhibit 1):

The Asian Development Bank (ADB) commented on the recent period that "Malaysia has achieved an impressive recovery since the Asian financial crisis" (which it achieved without IMF involvement; see section c). More detailed macro-economic data over a longer period demonstrate that this impressive performance has been both

71 Even allowing for some small and/or temporary distortions and subsidies

long and broad. For example, (as per exhibit 2) during the period 1970-2000 selected key indicators show that:

- GDP growth averaged around 7% p.a., though this average includes the low growth downturns in 1976, 1986 and 1998 and many individual years saw double-digit growth of 10% or more
- GNP per capita showed a similar growth rate, increasing about tenfold over the period from US$ 368 in 1970 to around US$ 3,600 (estimate for 2002)
- Unemployment and inflation both remained enviably low over the period, with unemployment down to 3.1% of the workforce[72] in 2000 and annual inflation down to 1.6% in the same year
- The balance of payments showed a healthy current account surplus through much of the period, with a current account surplus equivalent to 10% of GDP in 2000 and foreign reserves equal to about 5 months retained imports.

Driving this economic performance were two important structural transformations (supported by exhibit 3):

- The structure of GDP has been transformed from an agricultural/ extractive economy in 1970, when agriculture and mining accounted for 43.2% of GDP, to a manufacturing and services economy, together accounting for 81.4% of GDP in 2000.
- Similarly, the composition of exports has switched from overwhelmingly natural resources in 1970 (rubber, tin, palm oil, forestry/timber, oil and gas) to 85.5% manufacturers in 2001.

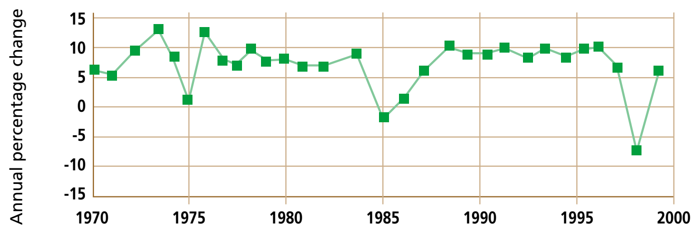
In addition, exhibit 4 illustrates that most major macro-economic accounts have generally performed well:

- Public sector finances have been prudent for most of the period, even running a small surplus in some years, with the exception of some modest deficits in the 80s (the deficit-financed "heavy industries" phase) and more significant deficits since the Asian crisis of 1998 (see also section d): "Challenges" below).
- The rate of national savings is high (mostly above 30% of GDP) and has outstripped investment in recent years
- Most of the balance of payments capital account has been financed by private capital flows, showing the important role of FDI

GROWTH, INFLATION AND UNEMPLOYMENT

Exhibit: 2

Real GDP growth in Malaysia



Major Economic Indicators

	1970	1980	1990	2000
GNP per capita (US$)	368	1,717	2,329	3,531
Unemployment (%)	7.4	5.6	5.1	3.1
Inflation (%)	1.9	6.7	3.1	1.6
Current a/c of BOP (% to GNP)	0.2	-1.2	-2.2	10.0

Source: EPU

Growth Performance Average

Average 1960's	6.0 %
Average 1970's	7.5 %
Average 1980's	5.8 %
Average 1990's	7.1 %
Average 1970-1990	6.7 %
Average 1991-2000	7.0 %
2000	8.3 %

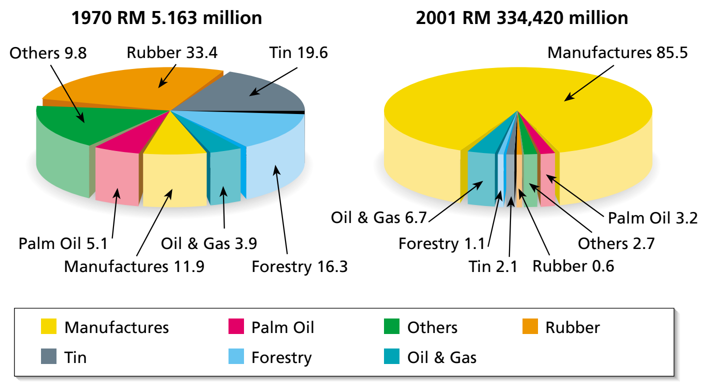
Source: EPU

Source: Compiled from IMF

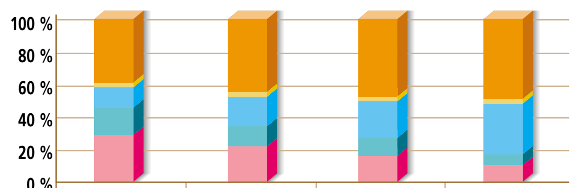
COMPOSITION OF GDP AND EXPORTS

Exhibit: 3

Diversification of Exports (% Total Exports)



Structure of production, 1970-2000 (% to GDP)



	1970	1980	1990	2000
Agriculture	26.7	21.0	16.3	8.4
Mining	16.5	12.1	9.4	6.9
Manufacturing	12.2	17.2	24.6	33.4
Construction	2.9	2.7	3.5	3.3
Services	36.7	47.0	46.8	48.0

Source: EPU

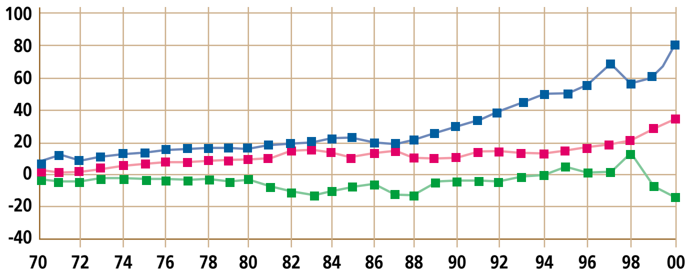
A crucial element in the macro economic success, and in the transformation of the GDP sector structure, has been the long-running heavy investment in physical infrastructure which has been maintained at around 20% of development expenditure for a 20 year period, as per exhibit 5. This is widely cited by the business community as an important variable in being efficient and competitive: Collectively it is clear that the trend performance (allowing for the cyclical dips in growth) has been very impressive. What government would not want around 7% annual GDP growth

72 This represents an overstatement of unemployment. In fact Malaysia has had a labour shortage for years, having an estimated 1-1.5 million migrant workers mostly from Indonesia and the Philippines in its labour force.

MACRO ACCOUNTS

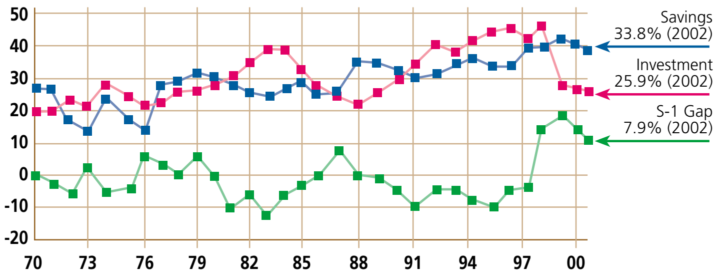
Exhibit: 4

Development Financing: Federal Government accounts 1970-2001 (RM billion)



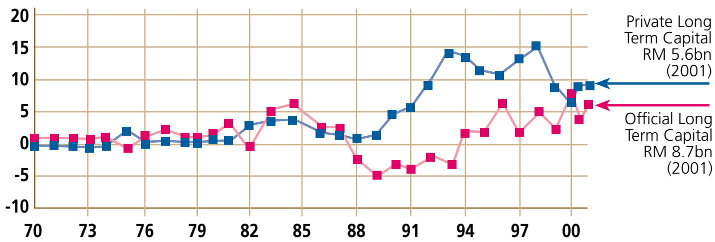
Revenue must cover operating expenditure and development expenditure must be financed through non-inflatary methods

Development Financing: Resource Balance, 1970-2002 (% to GNP)



Domestic savings are high and resource gap is financed by foreing savings in the form of foreing direct investment (FDI)

Account of BOP, 1970-2001 (RM billion)



Inflow of private long tem capital increased dramatically since late 1980's due to aggressive efforts to attract FDI

Source: EPU

DEVELOPMENT EXPENDITURE PHYSICAL INFRASTRUCTURE (% OF TOTAL)

Exhibit: 5

1986-90	1991-95	1996-2000	2001-2005
21.5	22.5	21.0	19.9

Source: EPU

combined with low inflation, low unemployment and a tenfold increase in per capita income over 30 years? Malaysia's development performance and capacity to create wealth provides much to be admired and envied.

b) Poverty reduction strategies

Except for hard-line adherents of "trickle down theories" and many undemocratic regimes, it is widely acknowledged around the world that wealth creation alone is not enough. A sensible and equitable distribution of such wealth is as important as the growth in wealth. If distribution policies fail or are non-existent, the powder-keg built up by inequality can lead to social unrest and destroy the conditions necessary for future wealth creation.

Malaysia's record in poverty reduction is impressive. There has been a long-term realisation and policy that there should be "growth with equity" and key statistics show a strong record in this:

- National development expenditures on the social sectors (education, health and housing) have increased from 24.8% in the 1986-90 period to 34.1 in the 2001-2005 period. Proportionate expenditure on health has doubled while that on education has also increased significantly (see exhibit 6):

- Linked to this is a clear improvement in many social indicators such as infant mortality, life expectancy, educational enrolment and literacy, and doctors per population etc. As shown in exhibit 7, these positive trends are evident in relation to Malaysia's own record from 1980, as well as evident in generally favourable comparisons with selected other Asian countries:

- The record on poverty reduction is strong, as the proportion of households below the defined poverty line has dropped from 49.3% in 1970 to about 7.5% in 1999, with a target that this should shrink to 0.5% by 2005 (see exhibit 8).

In addition, there have been long-standing rural development programmes and land development schemes which have provided additional impetus to income re-distribution and social stability. This important stability objective, coming after the prolonged period known as the "Emergency" (communist insurgency), has been further achieved with a strong social re-structuring policy which ensured that all sections of society participated in the economic growth process. By virtue of strong growth, these re-distributive policies did not disadvantage any group in absolute terms; all socio-economic groupings have gained (see footnote 9, section c) even though some have declined in proportionate terms.

This array of policies has aimed at attacking the causes as well as the symptoms of poverty. Human resource development and income generating projects tied into rural development programmes are emphasised over and above welfare handouts. While there is certainly further progress to be made in this crucial area, the data suggests that Malaysia has already achieved considerable success in its capacity to reduce poverty with social stability.

c) Development model

Malaysia has developed its own development management model which displays three rare features:

- The model shows strong elements of being "demand driven"
- The model has used little official finance/aid in the implementation process
- The model is not a standard recipe, or

ideology, but instead applies a mixed collection of tools to suit specific realities

All these features are relatively rare on the global stage, but together they demonstrate that Malaysia has the capacity to design and implement tailored policies to sustain wealth creation and address its particular needs in a non-standard way.

What does it mean to say that the development model is "demand driven"? It means that the model is built around an analysis of Malaysia's objectives and development needs. This is perfectly logical and correct. Yet it is in contrast to the "supply driven" nature of the mostly standardised development models available from the official international institutions. An analysis of the operations of these international institutions[73] indicates that there is little scope for substantial deviation from its financial product range or the conditionality attached to it, even when such deviation would benefit the borrower. Malaysia has accepted few such standardised products as they did not meet its own objectives and needs. In other words it has "not allowed itself to be bullied by men in suits (i.e. international bankers) who give hard-line advice dictated by ideology that they would never try to impose back home"[74]. Instead it has "shopped around", like any consumer looking for a product to satisfy their needs, and selected only some elements of the international development models and associated finance. In that sense, Malaysia's development model is "demand driven"; it exercises "consumer choice" and rejects those products and services of the international development model which do not fit with its requirements.

This has directly influenced the second noticeable feature of the Malaysian development model; the limited use of official finance/aid used in the implementation process. In fact:

a) The amount of official aid used to fund Malaysia's economic development is negligible relative to its GDP (less than 1% in the 90s)
b) The aid came mostly from bilateral sources, especially Japan (and not significantly from multilateral sources)
c) Malaysia has relied mostly on private capital flows, and especially FDI, for its international funding.

These statements, which are detailed further below, are of course partly a reflection of the relatively luxurious

73 See DFC's first report in this assignment, dated January 2002.
74 International Herald Tribune writing about economic development in Asia.

DEVELOPMENT EXPENDITURE GIVES PRIORITY TO ECONOMIC AND SOCIAL SECTOR (% TOTAL)

Exhibit 6: Social Expenditures

Sector	5 MP '86 - '90	6 MP '91 - '95	7 MP '96 - '00	8 MP '01 - '05
Economic	64.8	50.6	47.6	45.9
Agriculture	20.8	11.6	8.2	7.1
Industry	11.3	7.4	11.4	9.4
Infrastructure	21.5	22.5	21.0	19.9
Utilities	10.2	7.8	5.5	7.8
Social	24.8	24.8	31.6	34.1
Education	16.1	13.4	19.9	20.6
Health	2.6	4.4	3.8	5.0
Housing	4.1	3.3	3.4	3.8
Security	7.2	20.1	11.8	9.8
Administration	3.2	4.5	0.0	10.2
TOTAL	100.0	100.0	100.0	100.0
RM billion	35.3	54.7	99.0	110.0

Source: EPU

SOCIAL INDICATORS IN MALAYSIA 1980, 1990, 1997

Exhibit: 7

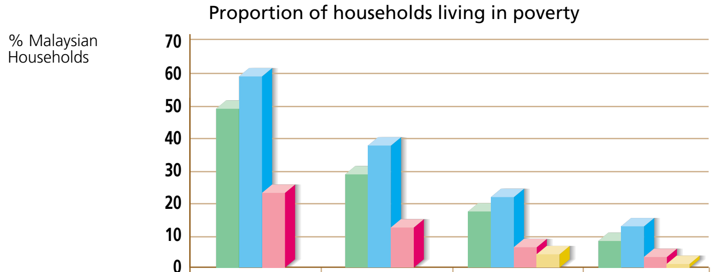
	1980	1990	1997
Infant mortality rate (per 1,000)			
Malaysia	30.4	15.8	7.9
EAP Total	55.3	39.9	34.8
Thailand Total	48.8	37.0	28.3
Life expectancy at birth (in years)			
Malaysia	66.9	70.5	72.3
EAP Total	64.5	67.4	69.0
Thailand Total	63.6	68.5	68.6
Primary school enrolment rate (in %)			
Malaysia	92.6	93.7	101.2
EAP Total	110.6	120.2	119.4
Secondary school enrolment rate (in %)			
Malaysia	47.7	56.3	64.0
EAP Total	44.2	48.1	68.9
Adult illiteracy rate (in %)			
Malaysia	28.6	19.1	13.0
EAP Total	31.2	20.9	14.9
Immunization DPT (% children under 12 months)			
Malaysia	58.0	89.0	89.0
EAP Total	49.0	92.0	81.9
Thailand Total	50.0	85.0	97.0

Source: Compiled from World Bank Development Indicators, various

POVERTY ERADICATION

Exhibit: 8

Proportion of households living in poverty



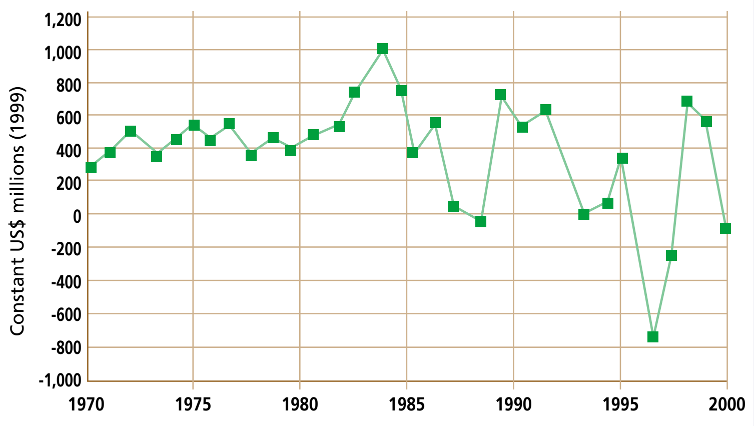
	1970	1980	1990	1999
Total	49.3	29.2	16.5	7.5
Rural	58.6	37.7	21.1	12.4
Urban	24.6	12.6	7.1	3.4
Hardcore poor	0	0	3.9	1.4

Source: EPU

Note: Poverty line income (PLI) for 1999 was RM 510 per month on peninsular Malaysia (household size 4.6); RM 685 in Sabah (household size 4.9) and RM 584 in Sarawak (household size 4.8). Hardcore poverty is estimated using half of PLI.

NET PUBLIC FLOWS EVOLUTION (ODF) IN MALAYSIA

Exhibit 9: Net Public Flows to Malaysia



Source: Compiled From OECD DAC Online Database

BILATERAL AND MULTILATERAL NET PUBLIC FLOWS (AS A PERCENTAGE OF TOTAL)

Exhibit: 10

		1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
Net ODF		**100**	**100**	**100**	**100**	**100**	**100**
	ODA	56.8	53.6	62.5	96.5	72.0	-39.1
	ODF	43.2	46.4	37.5	3.5	28.0	139.1
Bilateral		**65.9**	**49.2**	**62.0**	**89.4**	**101.7**	**117.8**
	ODA	51.0	46.3	53.8	89.7	69.6	-42.2
	OOF	14.9	2.9	8.2	-0.3	32.1	160.0
Multilateral		**34.1**	**47.6**	**34.1**	**8.9**	**-0.5**	**-14.4**
	ODA	5.8	4.8	4.8	5.1	3.7	6.5
	OOF	28.4	42.8	29.3	3.7	-4.2	-21.0

Source: Compiled From OECD DAC Online Database

DONOR DETAILS, NET ODA (US$m 1999)

Exhibit:11

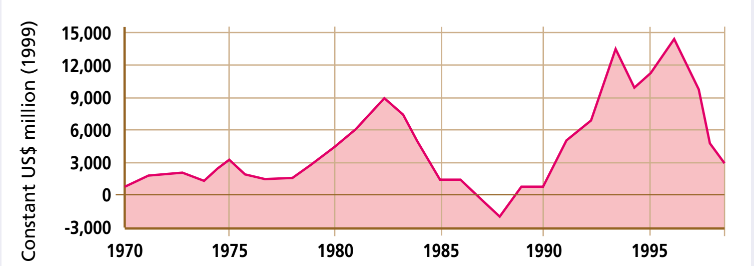
	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
EU Members*	20.78	14.82	49.91	28.87	17.26	16.39
Japan	87.66	162.29	261.57	172.43	176.00	-69.76
UK	52.31	17.95	10.32	39.29	29.92	-4.78
US	10.32	5.63	1.03	-0.79	0.00	0.00
Other	20.41	16.92	16.87	51.96	29.53	9.51
Total	191.47	217.61	339.69	291.76	252.71	-48.65

Source: Compiled From OECD DAC Online Database

* without UK

NET PRIVATE FLOWS EVOLUTION IN MALAYSIA

Exhibit: 12



Source: Compiled From World Bank Development Indicators, various

resource position that Malaysia has enjoyed over the past 30 years. It could afford to pick and choose and reject much official funding because it did not want the "strings" that were attached to that. But it should be pointed out that this is not solely a matter of resource endowment; to the contrary Malaysia has minimised its already low reliance on official finance mostly in the 90s when it had generated sufficient wealth from its manufacturing sector to be able to attract private finance. It was the model's own success which created the capacity to select the preferred and appropriate sources of finance. And the large volumes of FDI flowing to Malaysia were clearly a vote of confidence by the private sector in the Malaysian development model.

The data in exhibit 9 shows the limited reliance on official finance for Malaysia's development programme. Accounting for almost $500 million p.a. during 1970 to 1984, net ODF declined to $213 million on average in the following 13-years to 1997. Following the Asian crisis, net ODF reached $686 million in 1998. Large repayments meant that net ODF in 2000 was (-) $114 million. In recent decades, Malaysia has relied relatively little on public aid – aid as a proportion of GDP was 1 percent or less over the 90s, compared to 8.6% of GDP in 1972.

As illustrated in exhibit 10, bilateral donors dominated the small net public aid flows to Malaysia, except in 1975 to 1979 when net ODF was almost evenly divided between bilateral and multilateral donors. The vast proportion of bilateral aid was ODA up to 1990, when net OOF began to increase, accounting for 160% of net bilateral flows in 1995 to 1999. By contrast, net OOF remains the dominant source of multilateral funds, although ODA was important in 1995 to 1999. Bilateral flows refer to net ODF from the DAC countries.

Within the bilateral sources of official funds, Japan has been the most important over many years, contributing well over half of the total bilateral flows of ODA. In particular, it accounted for 77% on average of total flows in 1980 to 1984 or $261.6 million. The UK has been an important donor in the past, but from 1985 the 'other'[75] category has outpaced the EU members (without the UK) in terms of donor funds. The US has not been involved in public aid to Malaysia to any significant extent since 1994 (refer to exhibit 11).

Malaysia has relied heavily on private capital flows which have dwarfed official finance. These private flows were relatively constant over the 70s, annually averaging an already substantial $1.7 billion in real terms (constant US$ 1999), and reaching a high in 1982 before declining over the remainder of the 80s. Since then, there has been an enormous increase in net private capital flows reaching a peak of US$ 13.6 billion in 1996. Annual net private capital flows averaged $7.9 billion over the 90s compared to $3 billion during the 80s. There has been a fall-off since 1996

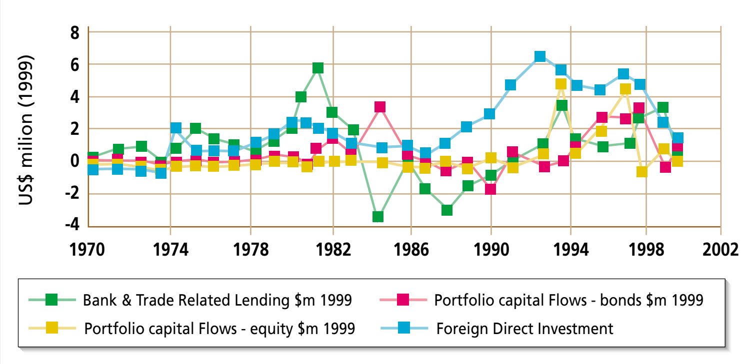
75 Switzerland, Australia, New Zealand and Canada.

following the Asian financial crisis. Still, overall these figures (see exhibit 12) show a strong vote of international confidence by the private sector in Malaysia's economy.

Apart from the large size of the private capital flows, it is significant that this shifted from bank and trade-related lending (which averaged US$720 million per annum in the 70s) towards foreign direct investment (FDI) which provided the spur from 1988 (though foreign direct investment has fallen off in the wake of the Asian crisis). FDI typically reflects a greater vote of confidence than other private flows (see exhibit 13).

COMPONENTS OF NET PRIVATE FLOWS

Exhibit: 13



Source: Compiled From World Bank Development Indicators, various

As is already evident from the discussion above about the "demand driven" nature of the model and the limited reliance on official finance, the Malaysian development model is not a standard recipe but instead applies a mixed collection of tools to suit specific realities. From an economist's perspective it has some unusual features in that it employs tools which suit specific objectives but which do not at first sight add up to a consistent policy ideology as generally understood. For example:

- It is an open economy driven by trade, FDI, and WTO membership, yet at the same time there have been selective tariffs and international protection (now being reduced to the automobile sector only)
- It is a market economy driven by the price mechanism, yet at the same time there remain subsidies and price intervention on selected goods
- It is an export-led economy, yet at the same time there are elements of import substitution in target industries
- It is a trading economy with free currency movements and floating exchange rates, yet at the same time there have been periods of exchange controls and fixed exchange rates (including from 1998 through to the present day)
- It is a private sector economy, yet at the same time there remains a strong public sector element in many activities[76]
- It is a socially responsible economy as evidenced by the poverty eradication strategies and improving social indicators (see section b) of this chapter), yet at the same time it has a long-running and widespread affirmative action programme in favour of the originally indigenous bumiputera population comprising approximately 60% of the total[77].

Many of these features have been interpreted by the international community as inconsistencies from a recognisable model and violations of international principles, and therefore condemned as undesirable. They have been the cause of considerable international criticism of Malaysia, mostly from government and "official" sources (the private sector has taken a clearly opposite view with their substantial FDI inflows; see above). It is not the role of this report to get involved in this debate, other than to make the following observations:

- The development model is based on in-depth analysis of specific development objectives and adopts the tools needed to reach those objectives. In that sense it resembles more a collection of policies than a fixed ideology. But as already demonstrated in section a) above, it has been successful in its achievement of most of the targets. So what is better; a collection of policies, based on analysis, which do actually achieve the objectives, or the adoption of a more or less standard ideology which fails to achieve a number of key objectives?
- The "policy inconsistencies" are often of a temporary nature and designed to steer the country through a difficult period or achieve other adjustments (e.g. most protective tariffs are now being eliminated; capital controls are expected to be phased out, etc.). Anyway, identical measures have been imposed by other countries e.g. the steel tariffs in the US, the recent capital controls in France, the long-running price distortions in the EU agriculture sector etc.
- The data underlying the "criticisms of principle" often throw a different light on the issues. See for example footnote 77 which deals with the re-structuring of the New Economic Policy.

So to conclude by referring back to the question posed at the outset of this chapter; "has Malaysia got the capacity to design policies and methods to sustain wealth creation?" As demonstrated in this section, the answer should be yes; it does. It has developed an innovative model based on analysis of specific objectives, and it has shopped for finance prudently and critically, obtaining the international finance which best suited its needs and preferences.

CORPORATE EQUITY OWNERSHIP (% TOTAL)

	Target		Achieved			%Change
	1970	1990	1990	1995	1999	1991-99
Bumiputra (indigenous)	2.4	30.0	19.3	20.6	19.1	12.3
Other Malaysians	32.3	40.0	46.8	43.4	40.3	10.5
Chinese	27.2		45.5	40.9	37.9	10.0
Indians	1.1		1.0	1.5	1.5	18.0
Others	4.0		0.3	1.0	0.9	29.9
Foreigners	63.3	30.0	26.4	27.7	32.7	15.6
Nominee	2.0		8.5	8.3	7.9	11.4
TOTAL (% total)	100.0	100.0	100.0	100.0	100.0	12.4
TOTAL (RM bn)	5.2		108.4	179.8	310.1	

Source: EPU

76 However, the public sector size is shrinking significantly with the on-going privatization programme. Since 1983, a total of 456 projects have been privatised, transferring 110,000 workers to the private sector, generating RM 23 billion in revenues and creating substantial extra value on the stock exchange (KLSE).

77 The data on the New Economic Policy shows two aspects not often mentioned; first that the ownership redistribution was from the foreign community to the indigenous groups, and second that the size of the equity cake being re-distributed grew so fast (from RM 5.2 billion in 1970 to RM 310 billion in 1999) that everyone has gained.

d) Responses to challenges

But all is not a bed of roses in Malaysia and there are some very significant challenges ahead. These come from diverse quarters and together pose some big headaches for the economic management team. In order to judge the real achievements of the "development performance" a fourth evaluation criterion is proposed: "can Malaysia react effectively to challenges and criticisms?"

Before forming a view on that, the nature of the challenges should be analysed. Without attempting to be comprehensive, even the more major challenges alone form a formidable list:

- There are many external challenges. These include thorny questions such as; (a) tackling the increased competition within the region for FDI, especially from China; (b) finding alternative export markets given the reduced growth rates in Malaysia's principal trading markets such as the US, the EU and Japan; (c) overcoming the challenges posed for hitherto protected industries by the forthcoming Asia Free Trade Association (AFTA); and (d) remaining competitive with the price of labour relative to its skill levels; etc.
- There are also many domestic challenges. These are well reviewed in the press and business literature in Malaysia[78] and include tough questions such as: (e) maintaining high quality standards in all aspects of public administration, transparency, anti-corruption, anti-abuse, etc – see also chapter 2; (f) improving education and adjusting it to the needs of the future in terms of language, commercial and technical skills; (g) developing the "post-FDI" economic model, possibly by focusing more on outward investment linked to international trade such as for example followed by the Netherlands and other smaller economies; (h) achieving success with the restructuring and crisis recovery programmes which are still under implementation, for example in the financial sector; (i) strengthening the poverty reduction programmes and thereby maintaining national unity; (j) continuing with the sector shifts towards higher value added industries such as IT intensive businesses and bio-sciences; (k) broadening and deepening the private sector; and (l) keeping top talent in the public sector by addressing the widening remuneration gap between the public and private sectors, etc.
- There is a third group which could be called "maturity" challenges[79]. These are simply a collection of issues that illustrate the painful adage that life does not become easier as you get richer. And Malaysia has become richer, so it too will experience some issues it has been able to side-step up to now. Richer economies have many more intractable problems which are tough to solve like increasing labour market rigidities, reductions in productivity increases, more "dying" industries and restructuring needs, greater scrapping requirements and therefore higher financial needs for investment renewal etc.

In the face of such a wide array of challenges, can Malaysia manage its way through this? In our view the answer to this question is "yes" and this judgment is based on four observations:

a) Malaysia has a strong record of achievement in the past and should therefore be able to use that experience to confront future challenges successfully
b) The economic management features (analysed in chapter 2) directly facilitate effective economic management. These include a close and open dialogue between the private sector and the public administration, a versatile and sophisticated use of the planning system, a hands-on style by top authorities such as the Economic Planning Unit (EPU) and the National Economic Action Council (NEAC), and a highly effective organisation for dealing with international trade and investors.
c) Malaysia has developed considerable skills in "crisis management" and resolved the 1998 financial crisis using its own approach without IMF involvement. This included developing a tailored set of policies to tackle the problems and taking some tough decisions on implementation at the highest level.
d) Malaysia has a demonstrated capability to launch new initiatives and ensure that they are implemented successfully, such as for example the numerous programmes associated with the promotion of IT industries and applications (see chapter 2).

In addition to that, there is also a broad consciousness of the challenges which are much debated and discussed. For example, the Central Bank of Malaysia writes in its Governor's message for its 2001 report published in March 2002: "Although Malaysia has made significant strides on several fronts, much still needs to be done and new challenges are emerging. The challenge to achieve sustainable growth and prosperity requires looking beyond the immediate term, beyond our own immediate interests, and beyond our own boundaries. While immediate concerns need to be addressed to preserve confidence and stability, the core of sustainable development is derived from the institutional strength and the fundamental structures and foundations. It is efforts directed towards these goals that will yield the broad-based high quality growth that we aim to achieve".

Conclusion

As abundantly evident in the four sections of this chapter, Malaysia's development record "has turned ripples into waves" and provides much to be admired and envied. Malaysia scores high on all four development performance evaluation criteria over a long, sustained period of time:

- Malaysia has a proven and powerful capacity to generate economic growth and create wealth
- Malaysia has a demonstrated and effective strategy to reduce poverty and ensure an equitable distribution of wealth
- Malaysia has a high capacity to develop its own policies and model for economic development, linked to a selective approach on financing the development programme
- Malaysia has the historic experience and management capacity to tackle the severe economic issues ahead.

PHASES OF ECONOMIC DEVELOPMENT

GDP/capita	Early development	Fast growth	Developed economy	Advanced developed
		Malaysia today?		
Sectors	Agriculture Mining	Agriculture Processing manufacturing	Manufacturing Services	High value manufacturing High value services
Key drivers	Natural resource Exploitation	Investment & human capital	Investment & human capital & infrastructure	Re-investment IT/knowledge & IT infrastructure

78 See especially "Malaysia's Economic Sustainability" by Dr Ramon Navaratnam (published 2002).

79 As countries move through various stages of development and per capita income growth, the nature of the key economic management issues, and the options available to solve them, often become more difficult than when dealing with a relatively "green field" situation typically found in the earlier phases of economic development.(see table above).

2. Institutional Infrastructure

In order to draw out lessons for other countries from the Malaysian experience, the most important question that arises is: "why has Malaysia been so successful over such a long time in its economic development?"

One line of response to this question is that Malaysia enjoys a strong endowment of resources. Many of these are natural, such as timber, rubber, tin, oil, palm oil, etc. Some of the resources relate to the geographical location of the country at the cross roads of strategic trade routes which allows transport and shipping industries to thrive. And some of the resource aspects are based on human capital; skills, education, productivity etc. which, in turn, are linked to the generally favourable heritage from the British colonial era. Analysts and observers of the Malaysian economic story readily admit that all these factors play a crucial part in explaining the track record.

Yet, other countries have enjoyed a resource endowment and not generated a correspondingly impressive development record. So the explanation of successful economic development has to be more than simply having the resources; it is about what you do with the resources, i.e. how they are managed. And this is where the experience of Malaysia is of particular interest to other countries because Malaysia has excelled in developing its institutional infrastructure. This comprises a wide range of elements which are not mutually exclusive and which act together to manage the development resources and process of the country. In this report we shall review the Malaysian experience in six of these institutional infrastructure elements:

- Political framework and public administration
- Macro-economic management
- Financial system
- Competition (domestic and international)
- Corporate governance and standards
- Commercial law and stability

Three observations are important before reviewing how these aspects are managed in Malaysia:

First, the real importance of examining the elements of institutional infrastructure is because they can be replicated. Unlike natural or geographic resources, which you either have or you don't, the management techniques embedded in the institutional infrastructure can be adapted and, with adjustments, copied by any country.

Second, the six elements of institutional infrastructure examined in this chapter are not the full list. The media, communications, information, the labour market, civil society etc are all further elements of the institutional infrastructure fabric in any country, but they are beyond the scope of this report.

Third, each element of institutional infrastructure (e.g. the financial system) comprises rules (laws, regulations etc), structure (institutions, organisations etc), and operational management (implementation efficiency and effectiveness). Generally, most countries have the rules and structure in place, but the failings arise in the operational management area. As will become evident in this chapter, Malaysia has advanced impressively in the operational management aspects; the "making it happen" or "management" of institutional infrastructure.

a) Political framework and public administration

The rules and structure of the political framework and public administration in Malaysia are developed and in many ways sophisticated.

Malaysia is a federal constitutional monarchy within the Commonwealth. The position of king is rotated between the 13 states every five years and the constitution defines powers between three layers of government: federal, state and local. Malaysia is a democracy with universal suffrage and there have been 11 national elections since independence with a choice of candidates from a range of political parties[80]. Majorities for the coalition ruling party have in the past been significant, allowing for strong government. This has provided a series of Prime Ministers with a strong platform for exercising visionary leadership, often in a "hands-on" manner. There have been some important shifts in the political landscape recently and the opposition parties are in power in two of the state governments. A further national election is due in 2002 for the Lower Chamber of 193 members.

It is frequently acknowledged that the British left behind an efficient administrative system, which an independent Malaysia subsequently proceeded to build upon. Today, the public administration machinery is a professional civil service with a highly developed set of rules and structure. There are extensive regulations, and institutions at several levels are of several types: the federal institutions, state and local, and the administration branch and implementation agencies. In all there are around 900,000 people on the state payroll in these numerous public bodies. The Auditor General exercises financial control, the Malaysia Administrative Modernisation and Management Planning Unit (MAMPU) exercises operational control, and the National Institute of Public Administration (INTAN) is responsible for training and development.

While the rules and structure of the political framework and the public administration are extensive and sophisticated, it is the operational management that has some impressive features which provide interesting lessons:

- The public administration is managed tightly on aspects that boost its operational effectiveness. Many of these measures are implemented by INTAN. For example:
  - All public administration employees must attend obligatory training at INTAN, which covers a wide range of practical topics including governance and other current priorities, and are delivered by around 650 staff at six campuses throughout Malaysia.
  - The high quality of INTAN's work is evidenced by its own ISO 9000 accreditation as well as its role in training many public servants from around 65 other countries through a foreign co-operation programme covering around 1500 participants per annum.
  - All government agencies are required to complete ISO 9000 and/or ISO 9001 accreditation by the end of 2002 for their core business processes, and about 400 of the 600 agencies affected by this have already done so.
  - There are charters defining service levels throughout the public administration, and adherence to these is controlled by the Public Service Department and also the extensive complaints procedures implemented by the Public Complaints Bureau. There are several channels for complaints, including web-based. Overall, this is leading to a consciousness of a "service culture" within the public administration and also identifying the continuing problem areas.
  - There are opportunities for professional exchanges with the private sector to enhance the diversity of experience in the public service cadre, and there are some pilot schemes for rewarding good performance in the public administration with bonuses.

80 There are numerous political parties but the dominant force remains a broad-based coalition (the Barisan Nasional) with its chief parties comprising the United Malays National Organisation (UMNO), the Malaysia Chinese Association (MCA) and the Malaysian Indian Congress (MIC). The coalition structure has in the past created the opportunity for significant majorities and strong government.

ECONOMIC PLANNING

Exhibit: 14

Planning Horizon	
LONG TERM PLANNING	
	Vision 2020, 1991, 2020
	First Outline Perspective Plan (OPP1), 1970-1990
	Second Outline Perspective Plan (OPP2), 1991-2000
	Third Outline Perspective Plan (OPP3), 2001-2010
MEDIUM TERM PLANNING	
	Five-year development plans, such as the Eighth Malaysia Plan (2001-2005)
	Mid-term review (MTR) of the five-year Plans
SHORT TERM PLANNING	
	Annual Budget

Source: EPU

- There is an increasingly open style in government, exemplified by some high profile Ministers such as the Minister of Industry and Trade who conducts open sessions in the regions about problems and their possible resolution. Such examples set the tone and filter through to other parts of the public administration. This is also reflected in the private sector's expectations of public service levels; for example the Federation of Malaysian Manufacturers (FMM) includes a section on red tape and government service in its quarterly survey of its members.
- There is an Anti-Corruption Agency (ACA) which has blown the whistle on several areas where malpractice was discovered, even though there are still questions about the extent of corrupt practices in government and the resources allocated to deal with it.

• There is significant innovation and a consciousness to reform and improve in many areas of government. This is an intangible phenomenon with an uneven impact, so far, but some examples illustrate the general trend:

- Under the slogan "re-inventing government", the Federal Government's move to Putrajaya has coincided with significant IT network developments which should yield major efficiency gains. It is an ambitious programme which will lead to a fully "electronic" government involving 24 federal ministries, 180 federal departments and statutory bodies, and 900,000 public sector employees, as well as 400,000 companies, 1.6 million proprietorships and 21 million citizens dealing with government bodies. It will take time to filter through to all areas of government but it is a symbolic start and is scheduled for completion in 2005.
- The hands-on style and top government culture contains clear elements of innovation, as evidenced by the reaction to the 1998 financial crisis and the development of policies with respect to other economic objectives.
- There is a clear consciousness to reduce red tape. For example, previously around 30 licences and permits would be needed to set up a business, many of these valid for only a year, while now 1 licence valid for 3 years is all that is needed.

• The financial structure of government contains some practical checks and balances which boost the operational management of the entire government machinery. The two principles throughout the system are:

- To separate the revenue collecting and spending channels. The federal government's tax authority collects the key taxes, while other state and federal authorities spend the money.
- To maintain competition for funds based on performance. All spending authorities need to persuade the Ministry of Finance that they deserve the funds applied for.

These aspects provide some indication of the high levels of efficiency and effectiveness in the operational management of the public administration. Not all these aspects are unique to Malaysia, and indeed some of these principles are also found in most OECD countries. But overall they illustrate the general notion that "things work" and government is aware that it needs "to improve further". This includes spending to improve; investing in IT, investing in training, investing in new facilities etc. For all these reasons the political system and public administration deserve a high score of 5 (i.e. "good"; see Section 4).

But this high score and impressive achievement should not mask the fact that this area faces some tough challenges. The trend may not be altogether favourable for several reasons:

• The gap between private and public sector wage levels is widening, presenting obvious problems for attracting and retaining talented staff, avoiding corruption and other financial malpractice etc.
• The high standards set and achieved at some centres of public service may not spread sufficiently to other areas, so that unevenness in service levels results.
• Continued investment in public administration quality improvements will be affected by other budget pressures linked to the present public sector deficit, including for example questions whether the level of resources allocated to the Anti-Corruption Agency is adequate for its task etc.

For these several reasons the trend in public administration quality can only be described as stable (see also Section 4).

b) Macro-economic management

The rules and structure of the macro-economic management machinery are interesting in Malaysia, as they comprise the normal key government ministries, such as the Ministry of Finance, but with several important additions.

The first feature is the widely-quoted and sophisticated economic planning system. This comprises long-term planning (20-30 year strategic visions and targets e.g. "Vision 2020"); medium-term planning (five year development plans and reviews); and short-term planning (the annual budgets). (Exhibit 14)

Second, the planning system is driven by several specialist institutions and groups, of which the key player has been the Economic Planning Unit (EPU) of the Prime Minister's Office. It has a permanent specialist staff that conducts the necessary analysis and provides several important committees and inter-agency groups with the required reports for decision taking. Since 1998 the National Economic Action Council (NEAC), which was initially charged with crisis management, has been added as an important senior group providing inputs on longer-term strategic aspects to the planning process. (Exhibit 15)

And third, as an over-arching concept, the macro-economic management is driven by "Malaysia Inc.", which basically views the country as a business and has a number of working committees promoting aspects of that business.

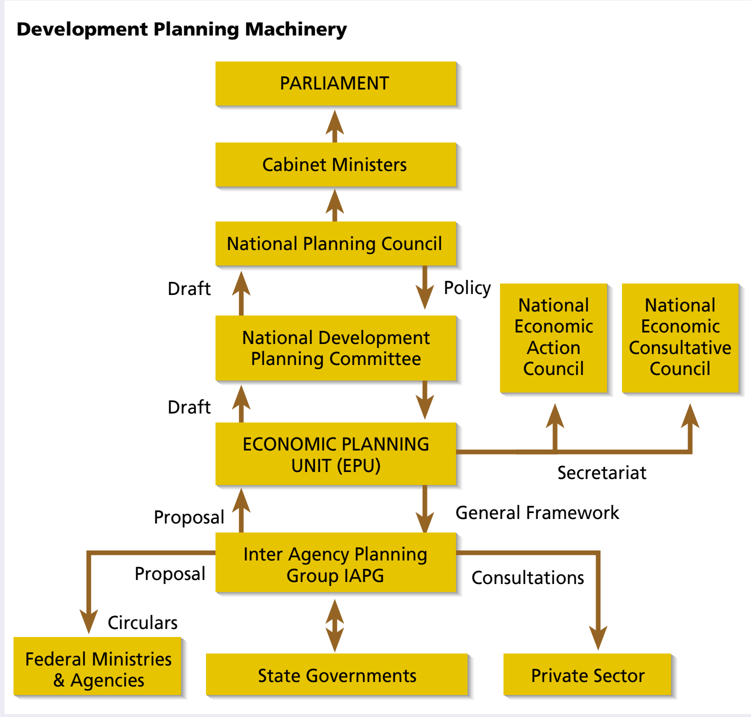
The rules and structure of this planning framework are possibly the most elaborate of any market economy nation, but it is the operational management of this macro-management framework that has the really interesting features which provide important lessons:

• The management of the planning process provides a number of important benefits which feed directly into the impressive economic performance of Malaysia. For example:

- It provides strong guidance and information which enhances the quality of business decisions. The business community, acting on

THE PLANNING INSTITUTIONS

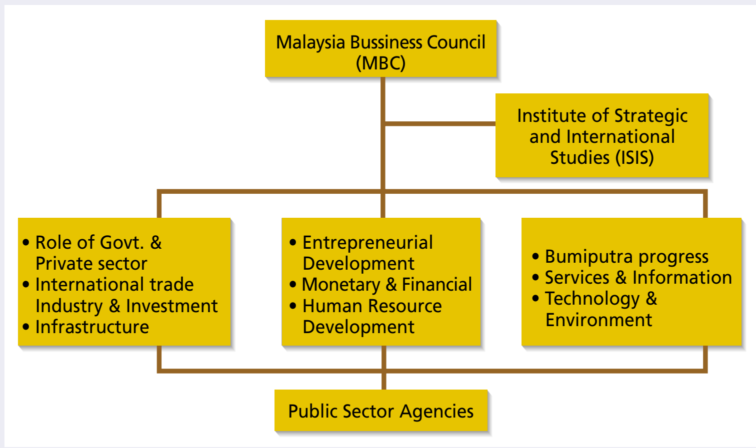
Exhibit: 15



Source: EPU

MALAYSIA INCORPORATED

Exhibit: 16



market and profit signals, knows where it stands and where it is going.
- It creates a sense of purpose and a company management atmosphere which has a similar beneficial effect on decision taking.
- But most of all, it provides for an open style of close and intensive dialogue and consultation between the public and private sector. This is especially important when the economy is developing rapidly and needs to move from sector to sector to re-position the country in the value-added chain and allow higher wages to be afforded etc. Non-Governmental Organisations (NGOs) are also included in this process of consultation. This process has also created an important atmosphere of "industrial peace" in labour relations.

- The control of implementation associated with the planning process is another important advantage of this macro-management tool. The ADB has also commented favourably on Malaysia's capacity for implementation, quoting in its country assessment report; "Overall, ADB's post-evaluation experience in Malaysia has been favourable". Two general features relating to implementation are important;
  - First, project implementation is usually left to specialist agencies and authorities. This is not unique to Malaysia, but it offers considerable advantages compared with leaving implementation to line Ministries as the agencies operate on a more commercial and business-like basis.
  - Second, implementation is controlled and monitored by the Implementation and Co-ordination Unit (ICU) that evaluates progress. The "progress report" directly affects the availability of further financing.

- The planning process is also an effective vehicle for launching new initiatives. One prominent example of this is the several initiatives driven by the National Information Technology Council (NITC) which is building on the Multi-Media Super Corridor (MSC) and driving a wide range of programmes to promote the spread of technology amongst different community groups.

For all these reasons, it is our judgment that the macro-economic management in Malaysia is consistently good and deserves a score of 6 (see Section 4). And with continuous refinements and greater use of IT, the trend is probably one of modest improvement.

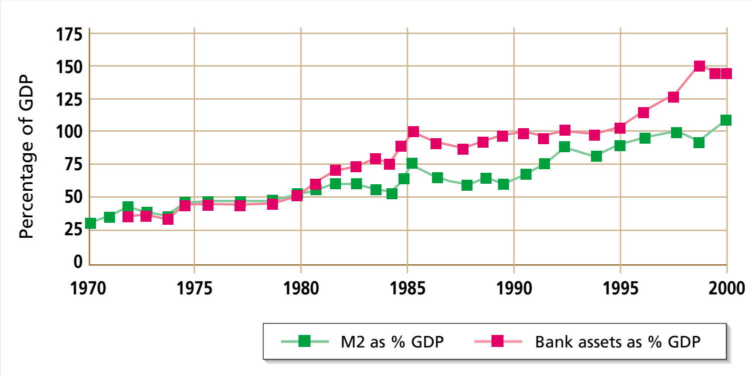
c) Financial system

The rules and structure of the financial sector are evolving and improving:

- There is a wide array of comprehensive legislation including key laws such as the Central Bank of Malaysia Act 1958 (revised 1994), the Banking and Financial Institutions Act 1989, the Securities Industry Act 1983 & 1991, the Offshore Banking Act 1990, the Insurance Act 1996, the Promotion of Investments Act 1986, the Takaful Act 1984 (for Islamic Banking), etc. These are complemented by further acts as well as the usual regulations.
- There is also a full set of supervising institutions centred principally on the central bank (Bank Negara Malaysia; BNM) which regulates and supervises the banking and insurance sectors, and the Securities Commission (SC) which regulates and supervises the capital markets.
- There are many associations of financial institutions in Malaysia, and there is full membership of international organisations such as the International Monetary Fund (joined 1958), the World Bank (joined 1958), the Asian Development Bank (joined 1966), the Islamic Development Bank (joined 1974) and the World Trade Organisation (joined 1995).
- Until recently, there was a wide array of licensed institutions in the commercial banking sector including 22 Malaysian banks and 13 foreign banks collectively employing around 64,000 staff. In addition there are around 36 foreign banks with representative offices in Malaysia. The commercial banks principal asset exposure was to the manufacturing sectors and lending for all categories of property.

FINANCIAL DEPTH IN MALAYSIA

Exhibit 17: Financial Assets as % of GDP



Source: Compiled From IMF - International Financial Statistics, various

- In addition there was (a) an extensive set of specialised financial institutions including finance companies, merchant banks, discount houses and special lending schemes as well as (b) a wide range of non-bank financial institutions including development finance companies, provident and pension funds, savings institutions, and other financial intermediaries. Further components of the institutional structure of the financial system include the insurance sector, the capital and derivatives markets comprising also the Kuala Lumpur Stock Exchange (KLSE), and the off-shore banking sector at Labuan.

The "depth" of the financial system (financial assets as a percentage of GDP) has increased from around 34% in 1972 to over 140% in 1999, after the financial crisis of 1998. (Exhibit 17)

At first sight, the rules and structure of the financial system look impressive. But in fact the operational management of the sector reveals a number of severe issues. In order to obtain a realistic picture, it is necessary to separate the pre-1998 crisis period from the more recent 3-4 year period.

The pre-1998 period was characterized by three major problems which came to a head in the crisis. The first problem was significant institutional fragmentation in the sector, which in turn triggered numerous other operational weaknesses in financial institutions which were basically too small. The second issue related to over-heating and inadequate risk management, which lead to non-performing loans reaching around 20% of total banking assets before deducting interest in suspense and specific provisions. This problem was concentrated in the construction and real estate sectors, as well as lending for the purchase of securities. And a third issue, closely linked to the first two, was that financial sector supervision did not yet include all financial institutions, so there were several un-regulated development finance institutions etc.

But what has happened over the last 3-4 years, post-crisis, is more relevant to an assessment of the operational management of the Malaysian financial sector. On the whole, the actions and planning of remedial re-structuring have been impressive and together read like a thorough analysis of world-class benchmark targets and actions. Although implementation is still underway and it is premature to evaluate many of the results, some of the positive aspects of recent action include:

- BNM, the central bank, has developed a "Financial sector master plan; building a secure future" that is truly masterly[81]. It reads like a text-book containing all the right actions and objectives over a wide range of financial sector issues. It defines the vision, details the consolidation process which is envisaged[82], lists a wide range of operational improvements banks are expected to achieve, opens up the sector by allowing foreign banks greater operational scope, and increases the supervisory net to include non-bank financial institutions. Similar objectives are set for the insurance sector. Both the banking and insurance sector restructuring will be achieved in three phases.
- For the capital markets a high quality "master plan" also exists that has been developed by the Securities Commission.
- Through the operations of Danaharta and Danamodal, two specialist institutions set up to deal with the bad debt problem and required re-capitalisation, the non-performing loans problem is being tackled quite aggressively.
- All this has happened quickly and with top-level attention to ensure that implementation is rapid and effective, at least in comparison with other countries attempting to do similar things. So by end-2000 capital adequacy ratios were around 12.4% on average and have remained at those levels. In the words of the ADB; "Malaysia has made considerable progress in financial sector restructuring".
- But some crisis-management measures are still in place that will need to be reviewed for the financial sector to flourish again, such as the selective capital and currency controls. There is now some debate on their relaxation.

Overall, the financial sector recovery plan and the first achievements under that plan are impressive. But there is still a long road to travel and the three phases of the master plans need years to be completed. Nevertheless the operational management of the financial sector deserves a score of 4 (i.e. satisfactory; see Section 4), and the trend is clearly improving.

d) Competition (international and domestic)

The rules and structure of competition in Malaysia are dominated by extensive consumer protection legislation which is considered to be best-practice standard, and on the international side by the Customs & Excise Department and the Ministry of Industry and Trade. There is no agency to control monopolistic actions.

Generalising, the economy is characterised as a market economy with free competition. It is also an open economy where growth has been largely export-led. Malaysia is a member of the World Trade Organisation and complies with its requirements, and Malaysia will also be a founder member of Asia Free Trade Association (AFTA) which is in the process of establishment.

The operational management of the competition structure suggests that the general trend is to boost the competitive "openness" of the Malaysian economy. Some of these measures are quite recent and include:

- Reductions in tariffs
- A liberalisation of the financial sector, with prospective greater freedoms for foreign banks (see section (c) above)
- Relaxation of foreign equity ownership restrictions[83]

Yet there remain some counter-forces which reduce the competitive intensity of certain parts of the Malaysian economy. For example tariffs remain in place for the motor vehicle industry, and selected

81 The documentation and analysis produced by BNM is first class. The institution has been rated the second most operationally effective central bank of emerging markets by a US research company.
82 The target is to move to 10 domestic banking groups each comprising a commercial bank, an investment/merchant bank, and a finance company.
83 Permitted foreign ownership will now increase to 100% in the manufacturing sector, 61% in the telecommunications sector, 49% in stock-broking, and 51% in insurance.

subsidies and price interventions also continue to exist. However, to put these in perspective, they are relatively minor and affect probably less than 10-15% of GDP. If this is linked to broader trends such as privatisation and overall de-regulation, it is fair to assess the operational management of competition in Malaysia as score 4 (i.e. satisfactory; see Section 4), with a trend which is improving.

e) Corporate governance and standards

Like the financial sector, a review of governance should be split into the pre- and post-crisis period.

The pre-crisis period before 1998 has not been reviewed for this report. However, the reforms in governance practices after the crisis were triggered by the shortcomings of the system which prevailed before. This included accusations of inadequate disclosure, cronyism in top job appointments, and areas of insufficiently defined standards.

But governance in the post-crisis period is more encouraging and headed in the right direction. The actions are largely based on the Finance Committee on Corporate Governance report of March 1999 and comprise three thrusts which affect the "rules, structure and operational management" of governance and standards:

- Transparency and disclosure are to improve[84]
- Codes and acts are to be reviewed[85]
- Institutions are to be more pro-active and effective[86]

In order to give some teeth to these measures, the Securities Commission (SC)[87] has restructured its enforcement department and placed greater emphasis on corporate compliance with assistance from the Attorney General's office. The SC reports non-compliant corporate activities to the Attorney General who holds the power to prosecute[88]. The powers of the KLSE have also been strengthened considerably following the Securities Commission (Amendment) Act in 2000. Moreover, in 1999, the KLSE introduced a memorandum on merger and acquisition rules designed to improve transparency in the business conduct of stock broking firms.

With this broad array of new measures and new institutional powers and responsibilities, as well as with the compulsory director's training courses at the Securities Commission, it can confidently be expected that corporate governance and standards are improving and will improve further. With a little more time, these improvements in transparency, disclosure, compliance control, corporate reporting, accounting standards, minority shareholder's rights[89] and creditor's rights will filter through to improve the overall quality of business decisions and investor confidence.

However, the process needs time. New institutional responsibilities need to be properly resourced and generally need to "find their feet". In addition there needs to be real "will" to ensure that the appointments to top jobs are based on merit; those performing poorly need to be removed and new appointments should be based on proven credentials for the task. There will be a time gap between achieving an improvement in governance standards and others perceiving that this is truly a reliable improvement. During 2001, Malaysia appeared to be exactly in that time gap as international investors (e.g. ING Barings, Morgan Stanley) reduced their Malaysia weightings. Failings in corporate governance practices were still cited as the main reason based on the continued perception, lagging behind changes in the reality, of shortcomings in corporate governance.

It is difficult under these circumstances to form a view on Malaysia's performance with respect to corporate governance. On paper it has reached the satisfactory score 4, if not higher, but the implementation is still underway and strong resolve continues to be needed to avoid returning to past practices (see Section 4). There can be confidence however that the trend is improving.

f) Commercial law and stability

The rules and structure of the Malaysian courts resemble those of England. Laws are both written (the Constitution and the acts passed by Parliament) and unwritten (i.e. like "common law" as practiced in England). Islamic law applies to Muslim citizens with respect to personal status matters.

The sub-ordinate courts comprise the magistrate and sessions courts, and there are three superior courts; two High Courts for peninsular Malaysia and the states of Sabah and Sarawak, the Federal Court (formerly Supreme Court) and the Court of Appeal[90]. There is also an Attorney General, and the three legal "roles" found in Malaysia are that of lawyer, notary public and commissioner for oaths (again resembling the system in England).

The review of the legal system is restricted to its commercial aspects as implied by the key question addressed in this report "what makes economic development successful?" No comments are therefore made on various international accusations levelled at the "independence" of the Malaysian court system[91].

The operational management of the commercial aspects of the law prompt the following observations:

- Through tough laws and penalties, social stability and "law and order" has been high. This has provided a welcome environment for business, especially considering the less stable situations prevailing from time to time in other Asian countries.
- Although time consuming, interviewees did not comment adversely on foreclosure on collateral title, nor on commercial dispute resolution. If anything, there were signs of recent improvements and "title" was usually clear.
- The International Centre for Commercial Law comments that "While foreign investors do not relish the prospect of going to court in Malaysia, their view is generally that the legal system does not present a problem to entry and that it offers a satisfactory level of protection".

There is inadequate data to form a detailed performance judgement for the operational management aspects of commercial law and stability, though the overall assessment is satisfactory (see Section 4).

84 The main actions are to set additional accounting and disclosure standards, enhance monitoring and surveillance, increase the accountability of company directors, and protect minority shareholders rights.

85 The Securities Commission (Amendment) Act 2000, passed by both houses of parliament in April, introduces enhanced disclosure obligations on issuers and stringent sanctions for false and misleading information in prospectuses. It grants the right to investors to pursue civil action against companies, directors and their advisors where there has been a contravention of the law. The SC is also empowered to pursue civil action on behalf of the investors when it is in the public interest to do so. The Malaysian code on corporate governance is voluntary in nature and sets out broad principles of good governance and best practices for listed companies. The amendment to KLSE's listing requirements requires companies to disclose in their annual report a narrative account of how they applied the principles of the code to their structures and processes and the extent to which they have complied with it. Finally the new listing will require directors to attend compulsory training programs (mandatory accreditation of directors).

86 This has triggered changes in rules and operations at the Securities Commission, the Kuala Lumpur Stock Exchange (KLSE), the Malaysia Central Depository, the Security Clearing Automated Network Services, the Malaysia Accounting Standards Board, the Auditor General's Office and other organisations. It has also led to the establishment of the Minority Shareholders Watchdog Group.

87 The SC is financially independent and reports to the Minister for Finance. It submits its accounts annually to the parliament.

88 Since 1999, the annual report of the SC sets out details of enforcement actions taken, details of complaints received and the status and names of those who have been charged. In 1999 the SC investigated 54 cases and initiated 23 prosecutions.

89 These rights are affected by, for example, listing rules, representation, board structure and duties, legal actions against directors, etc.

90 There is also a Special Court to hear cases brought against rulers.

91 While this report does not analyze the legal system as a whole, it is worth noting that in June 2002, the Asia Intelligence Report quoted the Political and Economic Risk Consultancy (PERC) as stating: "Malaysia arguably has the best legal system in Asia and has largely overcome the questions of its independence raised during the trial of former Deputy Prime Minister Datuk Sri Anwar Ibrahim. Throughout that controversial period, a lot of debate over the integrity and independence of the legal system was carried out by lawyers and judges. This is, therefore, an example of the checks and balances that still exist in Malaysia".

3. Lessons for other countries

The thesis of this report is that a well-functioning institutional infrastructure is needed in order to generate good economic development performance. In other words, a country can have natural resources and sensible economic policies, but if its institutional infrastructure is inadequate it will still not generate the development performance that it could potentially achieve. Our review of six well-functioning and/or improving dimensions of Malaysia's institutional infrastructure[92] has shown that these are an integral, but not sole, contributor to an enviable and impressive development performance over more than 30 years.

So the question arises; what can other countries learn from the Malaysian experience? The most powerful message is that they should develop their institutional infrastructure as Malaysia has done. At its simplest, this will initially entail programmes to:

- Improve the public administration's effectiveness and efficiency in policy implementation
- Adopt a hands-on economic management process which is tailored to economic and socio-cultural realities
- Restructure the financial sector in line with international benchmarks
- Insist that the full force of competition prevails overall in the domestic and international trade sector
- Force the application of best-practice in governance techniques
- Ensure that the process of (commercial) dispute resolution in the courts is satisfactory

But before examining the actions which could be undertaken to achieve this, some words of warning:

a) A well-functioning institutional infrastructure is no magic wand; it is needed in addition to resources, sound economic policies, and other development inputs. In other words it is necessary but not sufficient.
b) Methods of achieving top-flight institutional infrastructure are not always transferable across borders. They need to be adapted and modified to suit local socio-political and cultural realities.
c) Like all economic processes, time is needed. There is no overnight fix. A long-term vision and patient and consistent investment structured in prioritised phases are required to build a well-functioning institutional infrastructure.

Other countries could move a long way towards achieving a well-functioning institutional infrastructure if they implement a fifteen-pronged programme over time. These are:

Programme 1: **Create the foundations for strong government.** This will comprise:

- Introducing (or enhancing) democracy at all levels; national, regional and local. This should be based on universal suffrage and entail frequent and fair elections.
- Encouraging the formation of political parties representing a wide range of views and policies to enrich the diversity of government talent.
- Promoting the emergence of coalitions to provide a broad base for parliamentary majorities and thereby probably strengthen governments and the actions they could take.
- Supporting the development of visionary and hands-on leadership.

Programme 2: Invest in a high quality public administration. Key elements of this will be:

- Attracting and motivating the best human skills by structured recruitment programmes and performance assessments tied to bonuses.
- Ensuring that there is widespread and compulsory training to modernise and develop skills (this could include exchange programmes with the private sector).
- Instilling a service culture and setting service standards linked to an efficient and transparent complaints procedure.
- Investing in efficiency tools, including the physical infrastructure of the public administration, and especially the IT applications.
- Providing all needed resources to ensure that anti-corruption agencies can do their work effectively.

Programme 3: "Re-invent" the operations of government on a regular basis. This includes:

- Re-organising the institutions in government and the public administration to respond to new needs.
- Reviewing the "business processes" and work flow methods employed, and proposing improvements.
- Introducing new tools and methods such as best-practice benchmarking, accountability and performance measures etc.
- Boosting the "openness" and accessibility of government at all times by setting the example at ministerial levels.

Programme 4: Employ a sophisticated economic planning system. This is very wide ranging and must incorporate:

- Establishing well-defined planning machinery with institutionalised organisations, committees, procedures, timetables, and decision taking processes involving the highest levels of government.
- Creating clear time horizons, with distinctions between short-, medium- and long-term, while emphasising the latter.
- Institutionalising regular in-depth consultation and dialogue with a wide range of economic, business, labour and social groups.
- Catering for identified "customer segments" in the planning process e.g. foreign investors, a region, a minority group etc. and developing planning policies tailored to them.
- Learning that planning does not mean doing; once the plan defines priorities leave the economy to the business sector.

Programme 5: Develop analytical and policy formulation capabilities. While this sounds innocuous, it is in fact the foundation of several other important elements in a well-functioning institutional infrastructure and comprises:

- Running a programme to identify and train the necessary analytical staff; economists, financial specialists, business people, exporters, etc., which should include overseas training.
- Providing a "home" for this team, typically as part of the planning unit but possibly in an advisory unit or think tank of some kind.
- Developing world-class analytical techniques through a programme of exchanges and study tours.
- Producing the country's "own" economic analyses and development programmes to a better quality than what is typically provided by the multi-lateral development institutions.
- Promoting original and innovative policies tailored to the socio-economic realities of the nation, thereby avoiding standard recipes developed elsewhere for a different context.

Programme 6: Ensure that poverty reduction policies work. In some ways this is the most important development policy because all groups in society should benefit from the full array of economic policies in order to ensure social stability. This should include:

- Undertaking detailed analysis of social groupings and their poverty reduction needs.
- Designing an integrated package of poverty reduction policies to suit the separate segments, including rural development programmes, land

92 As already pointed out in this report, these six are not the "full list". Other important components of institutional infrastructure include media, communications, information, the labour market, civil society and others.

development programmes, village level civil society promotion, re-distribution objectives etc.
- Implementing these policies sensitively so that no group loses out, but that re-distribution is achieved with sufficient growth to ensure that all groups gain in absolute terms, even if some lose out in proportionate terms.

Programme 7: Learn to manage crises. Again, this sounds trivial, but in fact this is an important element in earning international respect and maintaining independence in decision taking. This embraces a range of "soft" variables:

- Introducing early warning systems to identify crises as early as possible so that they can be tackled while still "manageable" and not yet out of control.
- Assembling the right team to deal with all aspects of crises (analytical, prescriptive and decision aspects) and ensuring that the most senior representation allows tough decisions to be taken.
- Creating clear organisational and authority lines between the crisis management team and the normal economic management apparatus.
- Maintaining originality in the adopted crisis management measures, and avoiding standard recipes which may not fit the bill.

Programme 8: Become as selective as possible in external finance. Admittedly this is partly a matter of what a country can afford, but it is also a question of "behaviour". It should include:

- Defining the international financing needed for the development plan.
- Maintaining extensive information on availability and terms and conditions of international finance from all sources.
- Shopping around for the best deal which suits the country's needs, thereby avoiding the "automatic" nature of many long running multi-lateral development finance programmes.

Programme 9: Strengthen implementation capabilities. This comprises:

- Allocating implementation responsibilities exclusively to specialised agencies that already have, or will develop, the skills and appropriate behavioural style which suits the implementation objectives (i.e. avoiding implementation responsibilities in the public administration).
- Creating an implementation management team along the lines of the Implementation and Co-ordination Unit (ICU) in Malaysia that is responsible for performance monitoring and support.
- Reporting frequently and at senior level on implementation performance, triggering remedial action if necessary.

Programme 10: Instil key principles in public development finance. While this exists on paper in many countries, it must actually work in practice by:

- Separating the revenue collection and expenditure processes, at least at the authorisation levels.
- Allocating funds for development expenditure only on the basis of a bidding process driven by a demonstrated track record in implementation.
- Checking that all projects for financing are objectively and "independently" selected by complying with approved selection criteria.

Programme 11: Establish a long-term vision for financial sector restructuring. The health of the financial sector and its ability to mobilise and allocate domestic and international financial resources is a critical influence on overall development performance. It will require:

- Conducting an open debate on the main operational and structural configuration of the sector, taking into account international benchmarks and best-practice.
- Creating and publicising a long-term vision for the financial sector drawing on that debate and analysis.
- Designing the implementation mechanism and authority for achieving the vision.
- Providing the resources and institutions needed to clean-up and eliminate current problems in the sector.

Programme 12: Ensure that financial supervision is tight and applied equally. There are two main aspects to this:

- Establishing the full range of financial supervision institutions and creating world-class capabilities within them to really perform their on-site and off-site supervision tasks well.
- Avoiding "exceptions" so that all sub-sectors within the financial sector are supervised and that all institutions operating in those sub-sectors fall into the supervision net[93].

Programme 13: Promote and protect competition. This may appear a "motherhood" statement, but in fact there are specific institutional infrastructure aspects to develop, including:

- Protecting consumers with appropriate legislation backed by some form of watchdog system and associated legal rights.
- Creating a transparent and efficient customs and excise institution.
- Minimising licensing requirements for economic activity, but if there are any, ensuring that the licensing process and authority is efficient and transparent.
- Announcing that any distortions in free competition from, for example, price subsidies and/or customs duties are temporary and designed to achieve specific quantified objectives.

Programme 14: Achieve the best levels in corporate governance. This is a worldwide pre-occupation and difficult to achieve, but key elements will comprise:

- Reviewing the legal basis of governance by strengthening four areas; accounting and disclosure standards, monitoring and surveillance, directors' accountability, and minority shareholders' rights.
- Improving transparency and disclosure by enhancing accounting techniques and legislation.
- Empowering (new) institutions to play their part in achieving improvements in corporate governance, such as by providing training to directors, reviewing the listing information submitted by companies, or acting as a watchdog group for minority shareholders.

Programme 15: Keep the business sector happy with their legal rights. This is a programme involving three main aspects:

- Creating "law and order" and a secure environment by providing the necessary laws as well as enforcement mechanisms.
- Introducing a full set of commercial laws that clearly define rights and obligations, especially ownership title rights.
- Ensuring that the court system to resolve disputes operates efficiently and impartially.

To be of greater practical value for any nation wishing to adopt and implement them, these programmes will need to be detailed, prioritised in a phased programme and assigned to working parties. The working parties will need to have the right skills to do the design work and move on to implementation. They also need budgets. And they should report to the head of state who should take a personal, hands-on role in leading this effort to build the institutional infrastructure. It is a great effort taking time and money but, as amply demonstrated by the case of Malaysia, the rewards of a well-functioning institutional infrastructure are substantial.

93 Many countries have failed to supervise some key parts of the financial sector, such as for example the non-bank financial intermediaries, and also many countries allow public sector financial institutions to be partly or fully exempted from compliance with prudential limits, thereby leaving them effectively un-supervised.

INSTITUTIONS CONSULTED [94]

Our thanks are due to the institutions and individuals who kindly made time available to discuss the Malaysian economic model and/or to provide information. In alphabetic order by institution:

- Asian Strategy & Leadership Institute; Tan Sri (Dr) Ramon Navaratnam, Director ASLI, Group Corporate Adviser, The Sunway Group
- Bank Industri & Teknologi Malaysia Berhad; Mr. Nik Abdullah Shukri Nik Mustapha, Head, Group Corporate Planning & Research Department, Mr. Zamros Dzulkafli, Assistant Manager, Group Corporate Planning & Research Department
- Bank Negara Malaysia (the Central Bank); Mr. Suhaimi Ali, Senior Executive, Strategic Planning Unit (information and documentation)
- Economic Planning Unit, Prime Minister's Office[95]; Dr Victor Wee, Senior Director, Macroeconomics and Evaluation Section
- Federation of Malaysian Manufacturers; Mr. Lee Cheng Suan, CEO, Ms. Madeline Loh, Manager Economics Division
- INTAN; National Institute of Public Administration; Dr. Zulkurnain Haji Awang, Director/CEO
- Kuala Lumpur Stock Exchange; published information
- Malaysian Industrial Development Finance Berhad; Ms Tan Chek Yiang, Manager Research
- Ministry of Finance; published information
- Ministry of International Trade and Industry; Mr Joseph Doraisamy, Principal Assistant Director, Policy and Research together with colleagues from the policy team
- National Information Technology Council; Mr Wilson Wong, IT Policy and Strategy, together with colleagues
- National Institute of Accountants; published information
- Securities Commission of Malaysia; published information
- University of Malaysia; Department of Applied Economics; Professor Cassey Lee, Faculty of Applied Economics

94 Information was obtained either in person or through web-sites and publications. Several meetings were also held with private sector business executives representing a range of businesses and views. International sources were also used, including the Asian Development Bank and World Bank. This report has also benefited from the interesting and helpful insights contained in "Malaysia's Economic Sustainability" by Dr Ramon Navaratnam (Pelanduk Press; published 2002).

95 The report draws widely on the data and information kindly provided by the EPU.

DOCUMENTS CONSULTED

In alphabetic order, by author:

- Asian Development Bank; Economic Trends and Prospects. Also Country Performance Assessment 2002
- Bank Industri Malaysia Berhad; Assessment of Development Impact 1979-1998
- Bank Negara Malaysia: The Central Bank and the Financial System in Malaysia, 1999
- Bank Negara Malaysia; The Master Plan; building a secure future for the financial sector, 2001
- Bank Negara Malaysia; Annual Report 2001 and 1991-2000
- Business Times; Various articles
- Economic Planning Unit, Dr Victor Wee, Senior Director; Malaysia's Economic Development Process and Achievements, 2002
- Federation of Malaysian Manufacturers; Annual Report and other Documents;
- Institute of Public Administration; INTAN Training Projects and Technical Co-operation Programme, 2002
- Malaysia Industrial Development Finance Berhad; Annual report 2001
- National Information Technology Council; The Malaysian IT interface
- National Information Technology Council; Access, Empowerment and Governance in the Information Age
- Dr. Ramon Navaratnam; Malaysia's Economic Sustainability, 2002
- New Straits Times; Various articles
- Securities Commission; Capital Markets Master Plan

In addition a wide range of information available on the Internet was reviewed.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[96]					
		1	**2**	**3**	**4**	**5**	**6**
Political Framework & Public Administration	Rules					X	
	Structure					X	
	Management[97]					X	
	Combined Rating					**X**	
Macro-economic mgmt.	Rules						X
	Structure						X
	Management						X
	Combined Rating						**X**
Financial System (post-crisis)	Rules					X	
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Competition (domestic & international)	Rules					X	
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Corporate Governance & Standards	Rules					X	
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Commercial Law & Stability	Rules					X	
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Overall Rating						**X**	

96 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good
97 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political Framework & Public Administration	Objective Setting & Accountability					X	
	Quality of Personnel				X		
	Effective Decision Making					X	
	Efficiency of Procedures					X	
	Costs / Waste					X	
	Corruption			?			
	Combined Score					**X**	
Macro-economic mgmt.	Objective Setting & Accountability						X
	Quality of Personnel						X
	Effective Decision Making						X
	Efficiency of Procedures						X
	Costs / Waste						X
	Corruption					?	
	Combined Score						**X**
Financial System (post-crisis)	Objective Setting & Accountability					X	
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures				X		
	Costs / Waste				X		
	Corruption			?			
	Combined Score				**X**		
Competition (domestic & international)	Objective Setting & Accountability				X		
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures				X		
	Costs / Waste				?		
	Corruption			?			
	Combined Score				**X**		
Corporate Governance & Standards	Objective Setting & Accountability					X	
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures				X		
	Costs / Waste				?		
	Corruption			?			
	Combined Score				**X**		
Commercial Law & Stability [98]	Objective Setting & Accountability	NA					
	Quality of Personnel	NA					
	Effective Decision Making	NA					
	Efficiency of Procedures	NA					
	Costs / Waste	NA					
	Corruption	NA					
	Combined Score	**NA**					

98 Inadequate data to form detailed judgments

COUNTRY REPORT - MOROCCO

THE CASE OF DRIP-FED REFORM FORESTALLING REAL PROGRESS

1. DEVELOPMENT PERFORMANCE

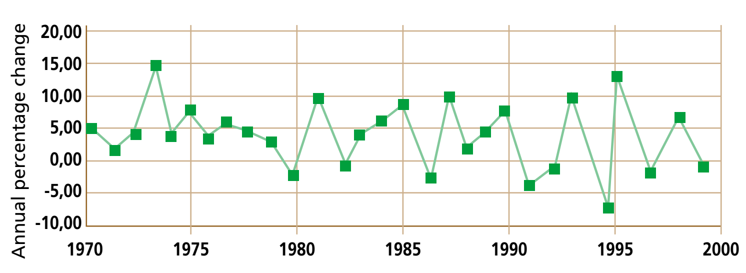
Following the financial crisis in the early 80s, Morocco embarked on an ambitious programme of macroeconomic, structural and trade reforms. It achieved impressive growth in the latter part of that decade which faltered then slowed significantly during the 90s.

1.1 Economic performance

Economic growth in Morocco has been on a declining trend over the last thirty years (see exhibit 1). Real GDP growth averaged 2% in the 90s versus 3.9% in the 80s and 5.5% in the 70s. Agriculture represents some 30% of GNP, but 45% of the population and 70% of the poor live in rural areas.

REAL GDP GROWTH IN MOROCCO

Exhibit: 1



Source: Compiled From World Economic Outlook Database: IMF

SOME INDICATORS AS A PERCENTAGE OF GDP

Exhibit: 2

	1972	1979	1983	1985	1990	1992	1996	1998	2000
Government deficit (-) / surplus as % GDP	-3.5	-9.7	-7.7	-7.2	-2.2	-1.4	-3.0	-2.1	-6.5
External debt (as a % of GDP)	23.3	49.5	91.7	122.6	94.7	77.5	59.6	57.4	n.a.

Source: International Financial Statistics: IMF

Growth over the 90s has been extremely volatile due to the greater recurrences of drought and declines in annual growth of the non-agricultural sector – annual growth declined from 3.9% in 1979-90 to 2.8% in 1991-97 (IMF, 1998). Annual growth in 1998 of 6.8% was achieved on the back of a recovery in agricultural production, favourable terms of trade, strong tourism receipts and a resurgence of private investment. The good performance was reversed in 1999, following a second year of drought. Real GDP growth fell by 0.8%. Further drought in 2000 resulted in agricultural production contracting by 17% and GDP real growth limited to 0.3% (IMF, 2001).

Macroeconomic stability has been a key priority since the introduction of the structural reforms introduced in 1983. As evidence, the Moroccan government has succeeded to have a downward trend of the inflation rate (averaging 4.6% over the 90s compared with 7.5% in the 80s) and has successfully maintained the current account deficit (under 1% of GDP in 1999). Moreover, structural reforms began to reap benefits in the 90s with a pickup in investment[99]. Foreign direct investment accounted for 3% of GDP in 2000 compared with 0.1% two decades earlier. However this figure was mainly boosted by the telecom sector and compares unfavourably with other comparable emerging markets.[100]

In particular, improvement in the fiscal deficit in 1998 and 1999 stemmed from the proceeds of a tax amnesty and the subsequent strengthening of corporate tax collection. The government's borrowing requirement has also been contained in recent times by privatisation receipts and GSM license receipts (IMF, 2000).

Important structural rigidities remain for the fiscal position. The public sector wage bill accounts for 12% of GDP and the tax exemption status of agriculture distorts the tax system as well as a system of food subsides (IMF, 2000). Moreover, the fiscal position is expected to experience a further widening in the deficit, as the authorities embrace an expansionary fiscal policy in the wake of drought, an increase in the wage bill and investment expenditures. Receipts from privatisation will ease the financing pressure but the IMF expects the deficit to continue its upward trend in the absence of new measures, not least because of the projected losses in customs revenues stemming from the Association Agreement with the European Union (IMF, 2000). Moreover, relying on privatisation receipts to finance current expenditures is not sustainable.

During the reform period in the 80s, external debt reached a high value of 122.6% of GDP in 1985. Since then external debt has been declining until 57.4% of GDP in 1999 (see exhibit 2). Government policy from the mid-90s has sought to reduce foreign indebtedness. The policies that followed have included active debt management, foreign direct investment and the substitution of domestic debt for external debt.[101] The value of external debt has also been helped by the further appreciation of the dollar vis-à-vis the euro. Nevertheless, debt service remains relatively high at 25% of exports of goods and services (IMF, 2001).

1.2 Trade

Morocco remains very dependent on the agricultural sector, which has become increasingly vulnerable to climatic changes and fluctuations in the world prices over the past two decades.

After the economic crisis in 1983 the government launched economic and trade reforms (reduced trade protection). As a consequence, during the second half of the 80s exports grew strongly at an annual rate of 14%.

99 The liberalization and privatization of the telecommunications sector brought in significant financial benefits and also reduced communication prices while creating a large number of jobs. The success of these efforts and the transparent manner in which they were carried out has strengthened Morocco's credibility as a destination for foreign investment. Other reforms noted in the IMF Article IV consultation was the elimination of the price subsidies on edible oils, an acceleration in rural infrastructure programs (electricity, drinking water and roads), reform of the social development agency (to address poverty and help disadvantaged women and children) the setting up of the National Agency for Employment (to establish better labor market intermediation) and the Royal Commission on Education Reform (one mandate of which is to achieve universal primary education by 2003).

100 Moroccan Manufacturing at the Turn of the Century .Results of the Firm Analysis and Competitiveness Survey (FACS –Morocco 2000) . Collaborative Project between the Ministry of Industry, Commerce, Energy and Mines and the World Bank. Published February 2002

101 Morocco signed debt-swap agreements with bilateral creditors, including Spain and France that resulted in a debt reduction of about $US365 million (IMF, 2001).

Since the beginning of the 90s Morocco has followed a stabilisation policy, but this has not enabled improvement in trade growth due to: 1) the fall of external competitiveness as the Moroccan currency appreciated and manufacturing exporters lost ground to competition and 2) the several droughts which hit agricultural exports hard. As a consequence Moroccan exports during the 90s grew at only 5% on an annual basis.

Morocco's imports during the first half of the 80s suffered a huge decrease due to the country's economic crisis (from US$3,771 million in 1980 to US$3,515 million in 1985, see exhibit 3). Since then, Moroccan imports have been increasing at an annual rate of 8% reflecting the need associated with the investment encouraged by economic adjustment and growth.

Trade deficit has stayed broadly unchanged in the recent years, accounting for 7-8% of GDP. In 2000 the economic slowdown mainly due to droughts and poor performance in traditional manufactured products (textiles) caused an increase in trade deficit up to 13% of GDP. (Exhibit 3)

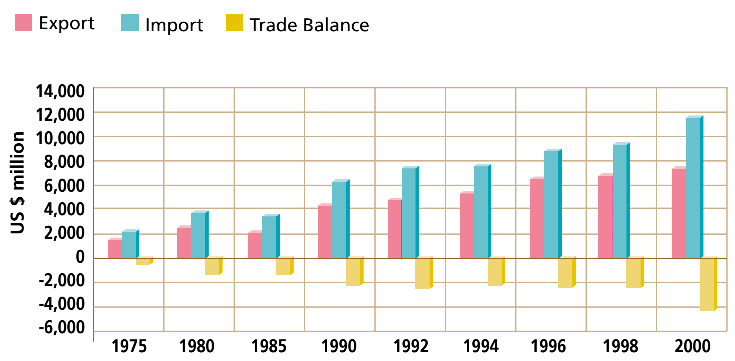
Exports from Morocco comprise three main groups: 1) agricultural and food items 2) manufactured goods (mainly textile) and 3) phosphate and phosphate derivatives (see exhibit 4). Morocco is the world's leading exporter of phosphates and possesses more than 50% of the world reserves of this mineral. During the last two decades there has been a shift on export shares in these three main groups, While in 1980 phosphates and agricultural and food items accounted for 62% share of total exports in the last decade manufactured products exports have hugely increased accounting in 2000 for 57% of total exports. (Exhibit 4)

The structure of Morocco's imports merchandise has changed over the last two decades reflecting the need of the investments. The shares of food and fuel and energy imports have declined (from 40% of total exports in 1980 to 30% in 2000) whereas imports of capital goods have in general increased (see exhibit 5 below).

As shown in exhibit 6, the European Union is Morocco's main trading partner. The main factors that have favoured trade with the EU include Morocco's lower labour costs, the preferential trade agreement granted to certain Moroccan products and proximity to Southern European markets. In terms of exports, more than 50% of Moroccan exports to the EU go to France (36% of total imports in 1999), with Spain (11%) and United Kingdom (9%) as second and third main EU export destinations. As for imports, France is again the main partner accounting for 26% of total imports in 1999. Trade with the United States is increasing with 6% of total imports in 1999.

TRADE IN MOROCCO

Exhibit: 3



Source: IMF and World Bank

MAIN EXPORT PRODUCTS (AS A PERCENTAGE OF TOTAL EXPORTS)

Exhibit: 4

	1980	1990	1999	2000
Phosphates	31	9	6	6
Agricultural and food items	31	25	21	21
Manufactures (mainly textile)	16	45	55	57
Others	22	21	18	16
Total	**100**	**100**	**100**	**100**

Source: World Bank

MAIN IMPORT PRODUCTS (AS A PERCENTAGE OF TOTAL EXPORTS)

Exhibit: 5

	1980	1990	1999	2000
Food	17	8	11	12
Fuel and energy	23	16	12	18
Capital goods*	19	25	26	21
Others	41	51	51	49
Total	**100**	**100**	**100**	**100**

Source: World Bank

* Includes machinery and equipments

1.3 Development aid

Official Aid flows

Total public flows of development aid to Morocco have fluctuated in real terms over the last thirty years, reaching a high of US$2,673 million in 1985 and a low of US$34.9 million in 1997 (see exhibit 7). Net ODF in 2000 was US$305 million, marginally below its 1970 level of US$519 million. Net ODF in real (constant US$ 1999) terms averaged just US$864 million annually over the 90s, compared with a US$169 million annual average over the 80s and US$888 million annual average over the 70s. Public aid as a proportion of GDP reached a high of 10.5% in 1985, declining to less than 1% in 2000.

Net ODA accounted for the majority of net ODF to Morocco, except in the five-year period 1985-1989, when net OOF accounted for 53.8% of total net ODF (see exhibit 8). Bilateral aid accounted for the larger part of net ODF over 1970-1974. Multilateral donors were the dominant lenders for the majority of the study period periods. In order of magnitude, these comprise the World Bank, the African Development Bank and the Arab Funds. Lending by the European Investment Bank (EIB) has increased under the MEDA Programme. The recently-approved additional Investment Facility may give a further impetus to EIB operations in Morocco. Lending from both bilateral and multilateral donors is more likely to be under official development assistance (ODA) than other official flows (OOF), whereas the latter accounted for the majority of multilateral lending except from 1994-1999 when 45% of the lending from multilaterals was in the form of ODA.

France is the dominant bilateral donor to Morocco, accounting for over 68% of net official development assistance (ODA) during 1995-1999, having increased from 36% at the start of the period, followed by Germany and Spain (see exhibit 9). Japan has increased its share of net ODA over the sample period, whilst the U.S. has progressively reduced its funding.

Since the signing in 1996 of the Association Agreement between Morocco and the European Union, EC grant funding to Morocco has been considerably enhanced under the first and second MEDA Programmes. Much of this funding (over 40%) has been allocated to support the economic transition process through budgetary support.

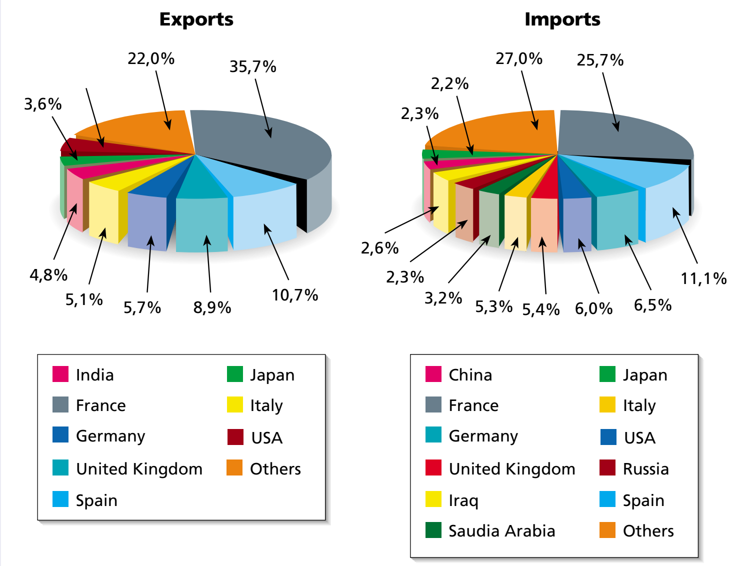
The main focus of ODF has been infrastructure development, especially transport, agriculture and health and education. Despite these investments, Morocco lacks an adequate road network, both between major centres of population and accessing more remote rural areas, basic infrastructures in rural areas are generally poor, and the social indicators show that, despite the resources allocated, Morocco has fallen behind its neighbours in the development of its education and health sectors (see 1.4 below).

Private aid flows

Net private capital flows in real (constant US$ million 1999) terms have fluctuated in a downward trend over the last three decades, as shown in exhibit 10. Net private capital flows in real terms averaged US$1.1 billion per annum over the 70s, US$767 million during the 80s and just US$368 million per annum during the 90s. As a proportion of GDP, net private capital flows reached almost 11% in 1976, but have accounted for just over 1% on average in the 90s. Unconfirmed figures suggest an improvement since 1999, with an increase to some US$ 600 million in 2001. This may be attributed to recent efforts to facilitate and promote FDI, which in 1999 reached US$831 million (through the Foreign Investment Department, recently established within the Ministry of Economy, Finance, Privatisation and Tourism).

MOROCCO MAIN TRADING PARTNERS

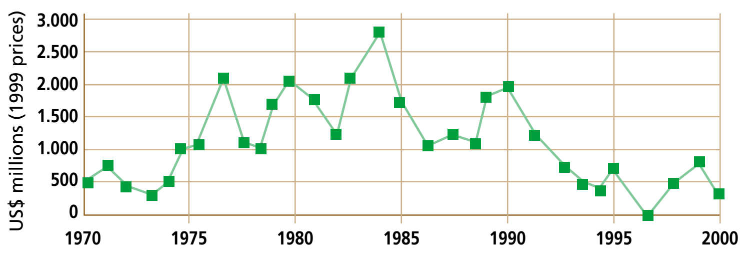
Exhibit:6



Source: Office des Changes, Morocco

NET PUBLIC EVOLUTION (ODF) IN MOROCCO

Exhibit: 7



Source: Compiled From OECD DAC Online Database

NET PUBLIC FLOWS BILATERAL AND MULTILATERAL COMPONENTS, (% SHARE)

Exhibit: 8

		1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
Net ODF		**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**
	ODA	79.19	69.13	70.50	46.20	74.83	110.40
	OOF	20.81	30.87	29.50	53.80	25.17	-10.40
Bilateral		**66.36**	**29.78**	**34.99**	**53.85**	**40.07**	**32.70**
	ODA	63.52	27.96	21.15	30.82	42.75	59.50
	OOF	2.84	1.82	13.84	23.03	-2.68	-26.80
Multilateral		**29.99**	**23.13**	**20.67**	**33.06**	**43.61**	**61.74**
	ODA	12.45	6.63	6.53	2.93	15.84	45.33
	OOF	17.54	16.49	14.14	30.13	27.76	16.40
Other		3.64	47.09	44.33	13.08	16.32	5.57

Source: Compiled From OECD DAC Online Database

DONOR DETAILS (% OF NET ODA, FIVE-YEAR AVERAGE)

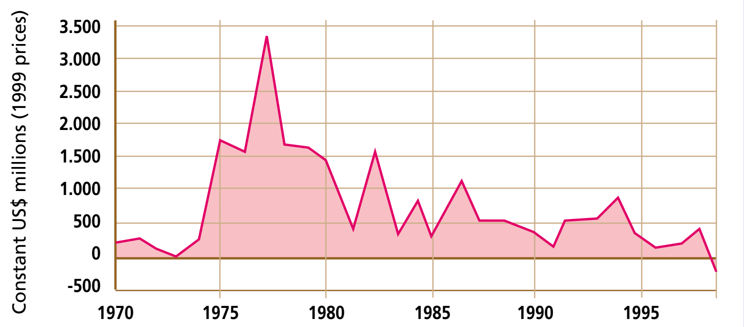
Exhibit: 9

	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
France	36.22	55.30	49.17	45.57	38.27	68.11
Rest of Europe	25.72	25.13	18.80	23.98	38.17	22.06
Japan	0.31	3.12	9.20	6.67	11.64	13.67
UK	0.08	0.06	3.08	0.16	1.90	0.22
US	33.91	14.61	17.86	20.01	7.00	-5.89
Other	3.77	1.78	1.89	3.62	3.02	1.83
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Compiled From OECD DAC Online Database

NET PRIVATE FLOWS EVOLUTION IN MOROCCO

Exhibit: 10



Source: Compiled From World Bank Development Indicators

AID AS A PERCENTAGE OF GDP

Exhibit: 11

	1970	1975	1980	1985	1990	1995	1999
Aid as % of GDP	3.1	4.0	5.2	8.5	6.6	1.5	0.8

Source: OECD DAC online Database

RATIO OF PRIVATE VERSUS OFFICIAL FLOWS

Exhibit: 12

	1970	1975	1980	1985	1990	1995	1999
Private/Official	0.4	1.8	0.9	0.1	0.4	0.9	-0.15

Source: OECD DAC online Database

Role of aid and its effectiveness

During the 80s and the beginning of the 90s, Official Aid (mainly multilateral) played a key role in Morocco's development supporting public investment financing to structural adjustment support. Presently due to the availability of concessional funds and revenues coming from privatisations Official Aid has became a less important source of financing. This downward trend is reflected in Exhibit 11. Whereas in 1984 Aid accounted for 8.5% of GDP, in 2000 it declined reaching less than 1% of GDP. In the late 90s the World Bank has indicated that a net negative transfer of resources and a number of loans granted by multilaterals were prepaid or cancelled during this period.

Overall, the ratio of private versus official flows in Morocco has remained similar (see exhibit 12). Private flows did not typically provide an important sum of financing for Morocco but are increasingly becoming a more important source of financing, especially foreign direct investment.

Evaluation Reports emanating from major donors in recent years suggest a number of weaknesses, which have impacted the effectiveness of aid, especially in the social sectors. These factors, which are further analysed in the following section, include:

- The difficulty of achieving consensus at the policy level in a multi-party government which is itself subject to the royal "writ" in all areas of decision-making.
- Excessive centralization at the executive level, an inheritance of French administration that has resulted in lack of cross-sector coordination and insufficient participation from stakeholders.
- Poor project implementation in the social sectors because of "inadequate technical and human capacities of administrative services in charge, and insufficient budget allocations" (ADB Country Strategy Paper).
- Lack of co-ordination between donors, particularly those without local representation. This has also been encouraged by a government position, which has taken the rather particular view that since all external financing transited through the budget, such co-ordination was unnecessary. The reality is one of national interest seeking to protect "sovereignty" in economic decision-making by managing relationships with each donor on a bilateral basis.

Aid and NGOs in Morocco

The NGO sector in Morocco is relatively young, highly fragmented with little commonality of mission, values or objectives. An updating of the legislation governing the activities of developmental NGOs is required, as is capacity building in the smaller segment of the sector.

There are a number of different types of NGOs in Morocco. The first is the grass root NGO, developed in response to a specific need in a community. Their leaders are often the elite and educated of that community or city dwellers, and most of their staff are volunteers. Others have been established by Islamic groups, especially in impoverished urban areas.

Another type is the development NGO, much smaller in number in Morocco. They have mainly arisen as a result of economic and structural reforms and tend to focus on more urgent social issues on a regional or country-wide basis. They may employ salaried staff and attract direct funding from donors.

There are few NGO federations or networks in Morocco, nor a comprehensive NGO database. This structure, or lack of one, poses a problem for donors who wish to interact with NGO focal points. The main foreign donors active in the sector are USAID, UNDP and the EC. Foundations promoted by the Royal family, such as the Hassan II Fund and the Mohammed V Foundation provide considerable support to NGOs. Also, a number of Ministries, notably the Ministry of Economic Incentives and the Ministry of Population, exercise some oversight on the activities of NGOs, which are regulated by a Dahir (royal decree) issued in 1958. The distinction was made between NGOs that serve the general needs of the community (associations of public utility – AUP in French) and those deemed by the state to only serve the needs of their members. AUP status accords the NGO advantages regarding fund-raising, taxes and other fiscal exemptions. It therefore plays a crucial role in determining whether an NGO can develop institutional and financial sustainability. Very few NGOs have AUP status.

A further Dahir was issued in 1998 to regulate the operations of micro-finance institutions, which are mainly, although not exclusively, NGOs. The World Bank has recommended new legislation targeted at development NGOs as a first step to revising the 1958 law which is now ill-adapted to the needs of the sector.

There are considerable needs for capacity building across the NGO sector but this will not be sufficient if the enabling environment for NGOs remains restrictive. An interesting example of a development NGO which operates nationally and on a cross-sectorial basis is the Zakoura Foundation. The Foundation was established in 1995 initially as a micro-finance provider targeting rural women. It presently employs 390 salaried staff and, since inception has granted some 200,000 micro-loans with a 99.7% recovery record. Funding has been provided principally by local banks, donors and royal foundations.

Progressively its activities have been extended to include primary education in rural areas, again addressed mainly to girls who have the least access, and then to adult illiteracy. Since 2001 the Foundation has developed its DID programmes (Développement Intégré des Douars – Integrated Village Development Programmes), which offer primary education, vocational and technical training, adult literacy, primary health care training, basic management training and access to micro-credit in modular six-year cycles. The Foundation employs a total staff of nearly 900, a number that would increase if additional funding became available for its rural development programmes.

1.4 Poverty reduction

Despite certain improving social indicators, absolute poverty has increased in Morocco. A Living Standards Measurement Survey (LSMS) in 1998-99 showed that the total number of poor increased from 13.1% of the population in 1990/91 to 19% in 1998/99 (from 3.4 to 5.3 million people). Moreover, those who are at are just below the 50% poverty line – the economically vulnerable population – increased from 35 to 44% (from 9 to 12 million people) as seen in the data in exhibit 13.

However, during the past two years, there has been an increasing awareness that poverty alleviation and social progress where key to enable Morocco to further develop. The King has recognized the need to address these social issues although no specific plan has been prepared.

Poverty increased mainly because of slow growth stemming from the problems experienced in the agricultural sector and their consequences for rural populations and because of the inability of the non-agricultural sector to generate the necessary employment opportunities to halt the rise in unemployment. Urban unemployment had risen to 22% of the labour force in 1999, from 15% in 1991, and is 27% among young graduates. A World Bank study[102] attributes 84% of the increase in poverty in the 90s at the national level to slow economic growth with the remainder due to unequal income distribution. Poverty is especially prevalent in rural areas, where the poor outnumbered those in the urban areas by two to one in 1998-99.

The structural causes of poverty are similar for both the urban and rural poor. The latter, while having access to agricultural land, typically farm small holdings that are rarely irrigated and are prevented from applying for formal credit to invest in the property due to lack of land titling and registration. The urban poor also face inadequate access to land, housing and basic services.

In general social indicators in Morocco have improved slightly over the last three decades (see exhibit 14). The most impressive decline has been the infant mortality rate (from 114 per 1,000 births in 1975 to 48 per 1,000 births in 1999) although it still remains higher than the regional average. Life expectancy at birth has increased over time reaching 67 years in 1999. The adult illiteracy rate of 48% in 1999 constitutes a major handicap for development.

POVERTY INDICATORS

Exhibit: 13

	1990-91			1998-99		
	Urban	Rural	**National**	Urban	Rural	**National**
Poverty Line (DH/per/year)	2,674	2,384	**2,495**	3,922	3,037	**3,337**
Incidence of Poverty (%)	7.6	18.0	**13.1**	12.0	27.2	**19.0**
Number of poor (in '000s)	912	2448	**3360**	1811	3496	**5307**
Number of economically vulnerable (50%PL, '000s)	2312	6640	**8952**	5034	7122	**12156**

Source: World Bank (2001)

SOCIAL INDICATORS IN MOROCCO

Exhibit: 14

	1975	1985	1995	1999
Infant mortality rate (per 1,000 births)	114.8	78.8	54.6	47.8
Life expectancy at birth (in years)	54.6	61	65.7	67.2
Primary school enrolment rate (in %)	62	77.2	83.7	n.a.
Secondary school enrolment rate (in %)	16.5	35.4	38.5	n.a.
Adult illiteracy rate (in %)	75.5	66.5	56	52
Immunization DPT (% children under 12 months)	n.a.	51	90	94

Source: Compiled from World Bank Development Indicators, various

COMPARATIVE PERFORMANCE 2000

Exhibit: 15

	Morocco	Middle East & North Africa	Lower middle income countries
Population (million)	28.7	296	2,046
GNI (Atlas method, US$ billion)	33.9	602	2,327
GNI per capita (atlas, US$)	1,180	2,040	1,140
Poverty (% population below national poverty line)	19	n.a.	n.a.
Urban population (% of total)	56	59	42
Infant mortality rate (per 1,000)	49	44	32
Life expectancy (years)	67	68	69
Access to improve water source (% of population)	82	89	80
Adult illiteracy rate (% of population)	51	35	15
Gross primary enrolment (% school age population)	86	95	114

Source: World Bank

Morocco relative performance compared with similar countries

Although there has been improvement in some social indicators, their performance is less impressive when judged against the regional average and against neighbouring countries (see exhibit 15). Social indicators related with education, e.g. adult illiteracy and primary gross enrolment still remains an issue in Morocco, being much worse than the regional average. Moreover, wide disparities remain across gender, with the gap between primary school and secondary school gross enrolment rates having narrowed marginally between 1975 and 1985. The Gender-Related-Development Index (GDI) confirms that Morocco continues to lag considerably behind all other comparable countries (World Bank, 2001).

2. INSTITUTIONAL INFRASTRUCTURE

2.1 Political system *(Overall rating 2)*

2.1.1 The Rules

The political system of the Kingdom of Morocco is a combination of a traditional monarchy with a limited parliamentary democracy.

When independence was achieved in 1956, Morocco inherited an administration and institutional framework, which was modelled on French practice. During the first six years of independence, although political parties had emerged prior to

102 The World Bank study states the increase in poverty was associated with a decline in manufacturing exports, slowdown in employment creation that led to an increase in urban unemployment, drought, agricultural policies and price changes that have contributed to an increase in rural poverty, a decline in international worker remittances, increased public expenditure in consumer food subsidies that diverted public resources and insufficient increases in public spending in social sectors (World Bank, 2001).

independence, the country was governed without a constitution until the death of Mohammed V. The first Constitution was introduced by Hassan II in 1961. It was drafted with the assistance of French advisors and in some respects was inspired by the 1958 French Constitution with the important and major difference that it established a constitutional monarchy of sorts as well as a single chamber Parliament. The powers of the monarchy are enshrined in Article 19 of the Constitution. From 1970, following two failed coup d'etats, the King ruled in an increasingly autocratic manner and his traditional role as a tribal leader with bearing a religious mantle received increasing prominence.

The fifth constitution adopted in 1996 confirmed Morocco's status as a constitutional monarchy, in which the King is head of the state, commander of the faithful and the armed forces. Despite reforms leading to greater democracy in the past few decades, the King continues to hold overall control. The King appoints the Prime Minister and a number of other key ministers and has the power to dismiss parliament and the government and to rule by decree.

The Advisors to the Court constitute an elite with considerable influence, which has frequently intervened in the implementation of economic policy when it has felt its interests to be threatened. The accession of Mohammed VI has been marked by an opening of the civil society, which has allowed the return of long term dissidents and the release of thousands of political prisoners. He has stressed the rule of law and social progress as main development objectives. Nevertheless the powers of the monarchy remain extensive and somewhat opaque in their exercise. There is no public scrutiny of the use of the substantial personal and public resources by the royal household, and the circle of royal advisors remains to some extent a government within government, though encouragingly less so under King Mohammed VI, who succeeded to the throne in 1999.

During much of the 70s and early 80s parliament was suspended and autocratic rule became the norm. The gap between elections has ranged from four to nine years, and the most recent elections took place in 1997. The forthcoming general elections were scheduled for November 2002. The 1996 constitution also recognizes a bi-cameral parliament with a lower house – the House of Representatives (325 seats) – elected by universal suffrage and an upper house – the Chamber of Advisers (270 seats) – chosen by an electoral college. Prior to this, a single system was in operation with two thirds directly elected and the remainder elected indirectly. The opposition is permitted to criticize the government on most issues except with regard to the role of the monarchy, the policy on Western Sahara[103] and Morocco's status as an Islamic country.

2.1.2 The Structure

Power remains highly centralized in the hands of the King who appoints the Prime Minister, has direct control over several Ministries and may dissolve the legislature at his discretion.

The political system is made up of parties from the right (wifaq), centre, non-party technocrats, palace appointees and the left[104]. Governments have been traditionally drawn from the right and centrist parties. In 1998, the King appointed the left-wing opposition leader, Mr. Youssoufi, to form a government thus breaking with tradition. This followed the election in January 1997[105] for the House of Representatives, which had returned almost identical weights for the wafiq, the centre and the koutla (parties of the opposition). The indirect election for the Chamber of Advisers returned the centre-right parties, reflecting the bias of the voters – three fifths of the members were chosen by local and regional councils, which are predominantly conservative (EIU, 2002).

2.1.3 Management

Notwithstanding the gradual evolution of democratic and accountable institutions, management remains highly centralised and the powers wielded by the elite around the palace remain considerable.

There has been debate regarding a further amendment to the Constitution, which might further "modernize" the monarchy along European models, although the spiritual role of the monarch will continue to set the institution apart from European systems. With this important difference, the Spanish model is one that has been regarded favourably by many political commentators. However the power and vested financial and economic interests around the throne are such that whether a democratic recasting of the role of the monarchy is possible, is open to conjecture. The fact remains that the political/economic influence of the "Court" during the past decade has slowed down the pace of reform in the financial sector and recent examples suggest that this continues under the new King.

The King has encouraged parallel policies of decentralization and "deconcentration" aimed at increasing administrative efficiencies and encouraging inward investment in the regions. The Law on Rationalization has established 16 regions headed by a regional governor (wali), which will take over some of the economic development role previously vested in the Ministry of the Interior. Thus the regions will be empowered to deal directly with private sector investors issuing permits and registering land title for investments up to US$10 million equivalent. They will also be expected to develop cross-sectoral programmes for regional development. The individuals appointed are technocrats rather than civil servants. However the structures are still being put in place and it is too early to assess the extent to which this new organization will effectively reduce some of the administrative bottlenecks that have been the bane of both donors and private investors. Mainly considered to be "technocrats" rather than political appointees, the governors have been personally appointed by the King.

The multiplicity of political parties that the present constitution allows is more of a reflection of the fact that many of the smaller parties represent the personal fiefs of individual politicians rather than widely different political platforms. The appointment of the present left - of - centre coalition was in part a response to criticism of widespread fraud in the 1997 Parliamentary elections. Although the government was pledged to a reformist programme, the retention of cabinet loyalists by the king and the difficulty of achieving consensus in a seven party coalition has reduced its ability to implement the agenda. Thus major and needy reforms such as that of the Labour Code[106] and of the pensions and social security have still to be achieved.

103 The issue of sovereignty over Western Sahara has been a taboo subject in Morocco on a par only with comment on the Royal family. The territory is an area of wasteland and desert between Mauritania and Morocco which is contested by Morocco and the Polisario, an independence movement based in the region of Tindouf, Algeria. Morocco's claim to sovereignty is based largely on a historical argument of traditional loyalty of the Sahrawi tribal leaders to the Moroccan Sultan as spiritual leader and ruler. The Polisario claim to represent the aspirations of the of the West Saharan inhabitants for independence. Algeria makes no territorial claim for itself, but has maintained that the Sahrawis should determine the territory's future status.

104 The wifaq is composed of the Union constitutionelle (UC), the Mouvement populaire (MP) and the Parti national démocratique (PND). The two centrist parties are the Rassemblement national des independents (RNI) and the Mouvement national populaire (MNP). The left is composed of the Union socialiste des forces populaires (USFP) and the Islamist Parti Istiqlal (PI). Two smaller-left leaning parties are the Parti du progress et du socialisme (PPS) and the Organisation pour l'action démocratique et populaire (OADP) (EIU, 2002).

105 The 1997 elections permitted a moderate Islamist group to stand, although affiliated with another party. The Mouvement populaire constitutionnel démocratique (MPCD) merged with Al-Islah wal –Tajdid (Unification and Reform) and won 9-seats in 1997. It changed its name to Parti de la justice et du développement (PJD) in 1998 in order to distinguish itself from other political parties with similar names but radically different agendas (EIU, 2002).

106 The present Labour Code dates from 1958 and is in urgent need of reform. It is widely regarded as over-protective and an obstacle to employment creation and as a deterrent to foreign investors.

Management is also hampered by a bloated civil administration the cost of which heavily impacts public finance and reduces the resources available for financing development projects and programmes (the cost of public service is estimated to have represented some 12% of GDP in 2001, absorbing some 50% of the budget). Despite this the government offered to create some 17,000 additional posts in order to avert a general strike. Whilst the present administration has envisaged measures to reorganize the structure of the administration and to improve management, once again the lack of consensus among the members of the coalition and strong resistance from those who feel threatened has delayed such reforms.

Aid Management

The department of treasury at the Ministry of Finance has the leading role of managing Foreign Assistance in Morocco. This process is effectively managed and has been so for a while. In Morocco there has been a long tradition of rigorous management in the Ministry of Finance. During the last years no corruption scandals have been reported.

2.2 Legal Framework *(Overall rating 2)*

2.2.1 The Rules

The Moroccan constitutional system is formally based on the principle of separation of powers and provides for the independence of the judiciary. However, the role of the King remains central to the system.

Magistrates are appointed by the King upon recommendation of the Judicial Court and are not removable. The Judicial Court is presided over by the King as guarantor of the Constitution.

The development of the Moroccan legal system has not kept pace with economic development in recent years and its mal-functioning has been identified as a key constraint to private sector development as well as the development of civil society. Major reforms required, which were identified in a 2000 World Bank review of the system, included: case management procedures in order to reduce the huge backlog of cases, even at Supreme Court level; transparency in judicial decision-making and predictability of judgements; capacity to enforce judgements; lack of judicial competence in general and in matters of commercial law in particular; lack of trained court personnel; absence of access to complete, up-to-date, legal information, including jurisprudence and an inadequate physical infrastructure.

2.2.2 The Structure

The structure of the legal system is determined by Article 82 of the Constitution. The highest court in the judicial structure is the Supreme Court. The organisation comprises common law, special and exceptional jurisdictions. Common law jurisdictions consist of 837 local courts, 68 tribunals, 21 appeal courts and the Supreme Court. The specialized courts comprise seven administrative tribunals, eight commercial courts three commercial courts of appeal and the High Court. The eight commercial courts were established in 1999, bringing about a more effective legal framework for resolving business conflicts, thereby improving the business environment for private investors.

2.2.3 Management

The management of the legal system has been adversely affected by over-centralisation and under-resourcing.

At the present time the judiciary is neither transparent nor fully independent and its ability to enforce laws and regulations is open to doubt. The system is notorious for the huge backlog of cases awaiting hearings, the unpredictability of decisions and corruption at all levels. These shortcomings have at last been recognised by government, which initiated a comprehensive five-year justice system reform programme in 2000 aimed at improving the enforceability of laws, regulations and contractual obligations. The programme is supported by the World Bank and the EC.

Among the weaknesses identified by the former[107] is the need for:

- The streamlining of judicial procedures, with particular emphasis on the codes of civil and commercial procedures
- The raising of professionalism of judges and other legal professionals through training and higher academic standards
- The rehabilitation and equipping of courts and extension of the court network
- The implementation of more effective and efficient court administration and case management systems
- The improved enforcement of judicial decisions
- The application of measures to strengthen ethical standards at all stages of legal procedures
- The access to up-to-date legal information (including legislation, regulations, court decisions and treaties) to all possible end-users
- The reform of the registers of commerce so as to ensure the security of business transactions
- The improvement of the legislative framework for commercial arbitration

It is a lengthy agenda, especially when associated with the need to significantly increase the number of judges and clerks, which requires several years' investment in human resource development.

2.3 Financial system *(Overall rating 3)*

2.3.1 The Rules

The banking sector is regulated by the Central Bank – Bank Al-Maghrib (BAM), which succeeded the Banque d'Etat du Maroc in 1959 (for additional information on the banking sector, refer to appendix 1).

The banking sector is governed by the Banking Law of July 1993, which merged the legal and supervisory frameworks for all credit institutions and which eliminated the distinction between the commercial banks and specialised financial institutions. However, in practice the specialised credit institutions continue to benefit from exemptions to the normal prudential requirements imposed by the BAM.

2.3.2 The Structure

The banking sector is at the centre of the Moroccan financial system with the Stock Exchange and savings institutions playing secondary roles.

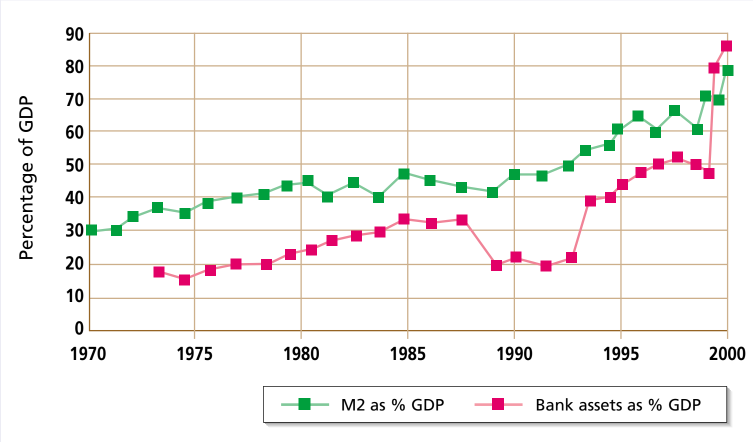
The credit institutions comprise 21 banks of which 14 are commercial, four are specialised and majority publicly-owned, and five foreign banks (four subsidiaries and one branch) as well as 70 finance companies. The specialised banks are the BNDE (enterprise development), the CIH (tourism and property finance), the CNCA (agricultural credit) and the FEC (local infrastructure financing)[108]. The commercial banks, which must have at least 51% majority Moroccan ownership, account for 78% of the non-consolidated assets of the banking system and the specialised banks have 22% of these assets. Foreign-owned banks accounted for 21% of banking sector assets at end 1998.

Infrastructure at the Casablanca Stock Exchange (CSE) has been modernized in recent years (EIU, 2002), comprising the introduction of an electronic quotation system, settlement through a central depository and clearing house and new market guarantees. The Conseil

107 Legal and Judicial Development Project. June 2000.
108 BNDE. Banque Nationale pour le Développement Economique. CIH Crédit Immobilier et Hôtelier. CNCA.Caisse Nationale de Crédit Agricole. FEC Fonds d'Equippement Communale.

FINANCIAL DEPTH IN MOROCCO

Exhibit: 16



Source: Compiled From IMF - International Financial Statistics, various

Déontologique des Valeurs Mobilières (CDVM) oversees transactions and campaigns for improved transparency of information. The CSE has no restrictions on foreign participation although this remains low (approximately 10% of total capitalization is in foreign hands). The International Financial Corporation (IFC) began listing the CSE in its composite index in 1997, as did Morgan Stanley in its Capital International emerging markets free index in 2000.

2.3.3 Management

The two main issues remain the apparent reluctance of the government to take decisive steps to fully withdraw from the banking sector and the lack of depth in the financial markets.

Financial reforms

Two sets of financial sector reforms were introduced in Morocco from the early 90s. The first in 1991 supported financial sector reforms aimed primarily at the banking sector (1991-1995) with further reforms introduced in the mid-90s for the development of capital markets and the liberalization of the financial sector (1996). More recent reforms (1998) targeted the savings institutions (insurance and pension funds). The main reforms implemented during the period were the elimination of credit ceilings, interest rate liberalization, overhaul of the legislative framework governing lending institutions, which included the adoption of a new Banking Law in 1993, gradual elimination of mandatory holdings of government securities and strengthening of the prudential regulation of banks in accordance with international standards.

With regard to capital market development, reforms focused on increasing the access of institutional investors to Treasury securities auctions, establishing a legal and regulatory framework governing stock market operations and mutual funds and the adoption of a law on marketable securities (titres de créance négociables, TCN).

International strategies have been conceived by three of the public sector banks following the liberalization of the banking sector. Large portfolios of non-performing loans, the lack of resolution to these portfolio problems and the future of the specialised credit institutions remain of major concern for the development of the banking sector. Senior officials of both the CNCA and CIH are under investigation for mismanagement of public funds.

There have been no bank failures in Morocco since liberalisation of the banking sector began, although the absorption of the BMAO by the BNDE as part of its strategy of developing a retail banking activity was essentially a "life-boat "operation. On the contrary commercial banks appear to be risk-averse, preferring investment in government bonds to corporate lending. A recent survey of more than 800 Moroccan firms suggested problems in terms of accessing credit at reasonable interest rates compared to other countries surveyed[109]. Supervision by the BAM appears to meet international standards. Three licenses were withdrawn from finance companies in 2000 for failing to adhere to prudential regulation.

Within the banking sector, which plays a dominant role in the Moroccan financial system, commercial banks account for 85% of GDP (1999) of total bank assets in Morocco. These Banks also control 80% of leasing companies, manage 70% of the assets of mutual funds and own 10 of the 15-brokerage firms (World Bank, 2000). According to the World Bank however, the size of the financial system is relatively small compared to regional and international standards, and less than 16% of the adult population has a bank account[110].

Assessment of the financial sector reforms indicates a greater level of financial intermediation as measured by the M2 ratio net of bank notes in circulation to GDP (see exhibit 16) and the observation that the financial sector is increasingly operating in accordance with market rules. However, the World Bank publication notes that this level of financial intermediation is low compared to international standards and compares unfavourably with that of Egypt and Jordan (respective ratios of 68 and 86% of GDP in 1998).

The rural community in Morocco has a lack of financial resources and appropriate credit financing which are not adequately covered, either by micro-finance institutions or by the NGOs delivering micro-finance services to the rural sector. The only institution that provides some financing is the CNCA (agricultural credit). But it does not own a very extensive network and its investment products are not adapted to the real needs of the rural community. A new management team is implementing a strategy to improve products and outreach.

The development of capital markets has been rather moribund in recent years. The development of the private pension and insurance sectors is also lagging behind. Privatisation has slowed and few medium sized companies have sought listing on the Stock Market. However, an exception was the highly successful liberalization of the Telecom sector both through the privatisation of the state-owned telecom company and the awarding of two GSM mobile phone licenses. The national airline carrier and tobacco company are to be privatised in the next 12 months.

2.4 Corporate Governance
(Overall rating 3)

2.4.1 The Rules

The government has recently taken steps to ensure more transparent economic and financial practices. In the private sector, application of regulations is impaired by weak enforcement.

Since 2000, the government has revived the Five-Year Plan as a framework for consultation, coordination and

109 FACS-Morocco 2000. February 2002.

110 Regionally the three largest Moroccan banks rank thirteenth, nineteenth and twenty-first among the 50 biggest banks on the African continent. The size of the banking system (about US$29 billion) implies a banking asset per capita ratio of about DH9,700 or the equivalent of US$900, compared with nearly US$2,000 in Tunisia (World Bank, 2000).

coherence of public expenditure programmes. A new decree was issued in 1999 reflecting international practice in procurement and introducing new structures to control and oversee public procurement. According to the World Bank, controls for commitment of public expenditure are sound, if cumbersome, at the central level. However, accountability would be strengthened by decentralisation and the establishment of regional auditors and controllers.

The legal framework for commercial activities was progressively modernized during the 90s. The Law on Joint Stock Companies (1996) provided for, inter alia, minority shareholder protection and more rigorous corporate governance. The Code des Sociétés (1997) provides businesses with a variety of structures to choose from when incorporating, while the Commercial Code made it possible for the first time, to address bankruptcies, liquidations and restructuring at an early stage.

2.4.2 The Structure

Administrative structures are clearly-defined but need to be further strengthened and decentralized.

Closely modelled on French practice, current government operations are monitored by the Cours des Comptes, whilst ex-post controls are exercised by the Inspection Générale des Finances (IGF). The World Bank has commented on the timeliness and quality of reports issued by the IGF as well as the auditing standards applied. It has also commented on the desirability of establishing Regional Cours des Comptes to ensure greater accountability and transparency.

The Institution of Chartered Accountants (Ordre des Experts Comptable) was established in 1994 and has been instrumental in advising the government on norms of good corporate governance as well as accounting standards. The General Confederation of Moroccan Businesses (CGEM) is also a forum for developing good governance practice. It has recently adopted a Good Conduct Code, based on best practice in France, Canada and the USA, to which its members are expected to subscribe.

2.4.3 Management

As in many other areas of Moroccan life there is a gap between the de jure and the de facto. In the domain of public governance there is a structure based on the robust French system and yet corruption among public officials remains endemic. The non-transparency and accountability surrounding the management of the finances of the Court and its entourage further blurs the picture.

In the private sector, the new laws and standards outlined in 2.2.1 above represented real progress. However the administration of business regulations has remained characterized by a lack of transparency, over-emphasis on controlling business activity and excessive scope for discretion. The following section focuses on the lack of transparency in the judicial system and the excessive delays in administering justice.

2.5 Trade and competition
(Overall rating 3)

2.5.1 The Rules

Although economic liberalisation has been a consistent policy of government, competitive pressures remain insufficient since liberalisation has not been uniform.

A tripartite consultative committee was set up in 1994 to advise on the implementation of a reform programme aimed at developing and enhancing the competitiveness of the private sector (Comité de Suivi) and progress was to be monitored by an Observatoire. In 1997 the government launched its industrial competitiveness (mise à niveau) programme aimed at preparing industry for the challenges of trade integration resulting from the Association Agreement[111] with the European Union. However, this programme, which is supported with funding from the European Commission, has been under-exploited and Moroccan industry and agriculture remains protected by tariffs which are high compared to key competitors.

Some progress has been made through the Law on Free Pricing and Competition, which came into effect in July 2001. Designed to set out a new legal framework for the economic regulation of the market that would promote free price formation through competition, free market access and the strengthening of rules regarding consumer information, the government retains the right to intervene on prices, either for structural reasons (monopoly or lack of competition), or for short-term reasons (crisis in the supply of a raw material such as oil, or a disaster affecting the population, such as drought). The Law aims to increase the transparency and fairness of trade relations by defining rules for these that relate to consumer information and protection. The competition investigation procedure is defined whereby abuses of the Law will be prosecuted through the court system.

However the absence of reform of the Labour Code and the relatively high comparative cost of labour, partly due to exchange rate policy, continue to be cited as major impediments to the competitiveness of Moroccan firms.

2.5.2 The Structure

A number of further measures have been recently introduced in order to improve competitiveness, but much remains to be done.

The private sector has been active though the CGEM which has evolved to become more representative in the dialogue with the government. It has opened its membership to smaller firms and to federations of companies outside the manufacturing sector and regional offices have been opened to expand the scope of the association.

At the institutional level, the Competition Council has been established. It is made up of experts with a consultative function in the area of anti-competitive practices. It examines the cases before it, provides technical advice and also makes proposals to the Prime Minister regarding the necessary action to be taken (refer to the WTO website).

A Directorate for External Investments was created within the Ministry of Finance in 1999. Its role is both to promote Morocco abroad and to provide assistance to investors. At the regional level, as part of the process of decentralization, Caisses Régionales d'Investissements are being established in the 16 regions which will provide "one-stop shop services" to businesses, whether local or foreign investors. Efforts have also been made to improve the efficiency of ports and customs procedures, with apparent success.

On the trade side, Morocco's trade policy combines progressive import liberalization with the promotion of industrial exports and protection for certain agricultural staples and manufactured goods. On the import side, domestic production is protected by a number of measures such as the licenses required for a few products and import duties. Subsidies have been granted in order to encourage the consumption of certain locally-produced agricultural products.

2.5.3 Management

Foreign investment into Morocco, excluding the proceeds of telecom sales, has doubled in the past three years, reaching US$600 million in 2001. Yet, significant challenges remain for increasing the competitiveness of agriculture and fisheries, shifting industry to higher value-added or skill-intensive production and developing tourism.

111 Morocco signed the Association Agreement with the EU in 1996 that came into force in 2000. Moroccan firms have been shielded for years by high import tariffs and will face increasing difficulties as these barriers are reduced in line with the Association Agreement until 2010.

Morocco has been moderately successful in attracting increasing and diversifying FDI. However major challenges remain in diversifying its rural economy whilst reducing the tariff protection of agricultural production and its manufacturing sector. The FACS also points to the problem of the low educational level of the workforce and the lack of training offered by firms. This is a critical factor affecting competitiveness since at current wage levels, Moroccan manufacturing cannot sustain a strategy of reliance on low-tech, low-skill content products.

Development of the fishing industry is a key aim of government. By 2003 Morocco aims to be among the top 15 fishing nations with a production of 1.5 million tonnes compared to 825,000 tonnes for 2000. The former agreement with the EU regarding fishing rights lapsed in 1999. Any new agreement would reduce the number of EU vessels allowed in Moroccan waters.

The government has an ambitious programme of development of the tourism sector as a "third pillar" of the economy, more than quadrupling the present annual intake to 10 million by the year 2010. Morocco has a number of potential attractions such as its little-developed coastline, the striking landscapes of the interior, its history and folklore, and proximity to mainland Europe. However it also has a number of major handicaps such as a relatively undeveloped transport infrastructure, lax environmental standards and a lack of entertainment venues and modern hotels. The lifting of numerous restrictions and a more proactive investment promotion have attracted international promoters who are involved in some 80 development projects throughout the country. Nevertheless it will have to compete with well-established markets such as Egypt, Tunisia and Turkey and consequently this ambitious target may prove hard to reach.

A recent government study estimated that approximately one third of existing industrial firms should be able to compete directly with their European counterparts, a further third should be able to adapt with time and the remaining third will not survive. The government launched a mise à niveau programme to modernise Moroccan firms. However, few firms have taken advantage of this facility, possibly due to reservations about opening their books to outside scrutiny. Another issue is the firms' ability or willingness to finance the additional investments required to upgrade their assets and to retrain personnel. Risk capital made available by the EIB has had little take up because of the reticence of local investors to invest additional equity.

3. CONCLUSIONS

Morocco's slow growth trend in the past ten years has contrasted sharply with that of many comparable middle-income countries.

The political transition which took place during the last two years' reign of the late King and since the accession of King Mohammed VI has seen Morocco develop as a more pluralistic society. However, economic and social reforms have been long in implementation and consensus-building in the seven-party government slowed down decision-making on economic policy. Weaker economic growth was exacerbated by the two years of severe drought in 1999 and 2000. Both urban and rural poverty have increased markedly as has unemployment, and a sizeable middle class has still to emerge. Resources, including a large part of development aid, which have been allocated to the social sectors have not been successful in narrowing the gap between rural and urban areas. As the deadline for the Association Agreement with the European Union approaches, real progress in upgrading the competitiveness of Moroccan agriculture and industry has been lacking.

Although external assistance has been significant over the same period, its development impact has been modest.

Our analysis has indicated a number of factors that have contributed to this failure to achieve results in the past decade. These include:

- The deceleration of the reform processes engaged in the 80s and early 90s leaving major problem areas such as judicial reform, civil service reform and the revamping of the labour code to be addressed.
- The unwillingness of the powerful vested interests that surround the Court to allow a quicker pace of liberalisation, especially of the financial sector.
- A lack of co-ordination between donors, which has been encouraged by government, and a lack of co-ordination between government departments and agencies. This has delayed the efficient transfer of resources and impacted the effective delivery.
- The prevalent centralisation, which has resulted in the government's failure to adequately address development issues in the peripheral areas of the country concerning both the provision of social services and of basic infrastructures. This has been partially compensated through the efforts of NGOs.
- The absence of transparency and of accountability of a significant segment of public finance (i.e. the royal "purse") notwithstanding the recent dynastic change.
- The lack of engagement of the private sector in the mise á niveau process and appetite to embrace the opportunities and face the challenges offered by the Association Agreement with the EU.

There are thus considerable shortcomings in the institutional infrastructure so that our overall scoring comes out at a low 2.7.

Nevertheless, Morocco has currently a limited window of opportunity during which to accelerate the reform process whilst strengthening human resources and addressing social deprivation. The opportunity arises essentially from a successful track record in economic stabilization over the previous decade and the prospect of windfall revenues from privatisations. Added to these factors are the measures that have already been taken to decentralise administration and to facilitate inward investment. Nevertheless a strong government will be required to achieve the second phase of the reform agenda, closer co-ordination both with donors on issues related to competitiveness and EU integration and with NGOs on poverty issues. The Coalition Government resulting from the November 2002 elections has not yet produced a clear agenda for further reforms. Also critical will be the willingness of the elite around the Palace and the Palace itself to allow necessary reforms to go forward. The alternative may be rising tensions as social disparities increase leading to instability or worse at an important crossroad in the country's modern development.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[112]					
		1	**2**	**3**	**4**	**5**	**6**
Political System	Rules		X				
	Structure			X			
	Management[113]		X				
	Combined Rating		**X**				
Legal Framework	Rules			X			
	Structure		X				
	Management		X				
	Combined Rating		**X**				
Financial System	Rules				X		
	Structure			X			
	Management			X			
	Combined Rating			**X**			
Corporate Governance	Rules			X			
	Structure			X			
	Management		X				
	Combined Rating			**X**			
Trade & Competition	Rules			X			
	Structure			X			
	Management		X				
	Combined Rating			**X**			
Overall Rating			**X 2.7**				

112 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good

113 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability		X				
	Quality of Personnel			X			
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Legal Framework	Objective Setting & Accountability		X				
	Quality of Personnel	X					
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Financial System	Objective Setting & Accountability			X			
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures				X		
	Costs / Waste				X		
	Corruption				X		
	Combined Score			**X**			
Corporate Governance	Objective Setting & Accountability			X			
	Quality of Personnel			X			
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption			X			
	Combined Score		**X**				
Trade & Competition	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption			X			
	Combined Score		**X**				

ADDITIONAL INFORMATION ON THE BANKING SECTOR

1-Entry		Morocco
1.1 Licensing authority		Minister of Finance upon recommendation from the Credit Establishment Committee
1.2 Number of banks		21
1.3 Minimum capital entry requirement		MAD 100
1.4 Is information on source of funds for capital required?		Yes
1.5 Are the sources of funds to be used as capital verified by authorities?		Yes
1.5.1 Are law enforcement authorities consulted?		
1.6 Can assets other than cash/govt. securities be used to increase capital?		Yes
1.7 Can borrowed funds be used?		No
1.8 Legal submissions required for banking license:	1.8.1 Draft by-laws	Yes
	1.8.2 Intended organization chart	Yes
	1.8.3 First 3-year financial projections	Yes
	1.8.4 Financial information on shareholders	Yes
	1.8.5 Background/ experience of future directors	Yes
	1.8.6 Background/ experience of future managers	Yes
	1.8.7 Sources of funds in capitalization of new bank	Yes
	1.8.8 Intended market differentiation of new bank	Yes
1.9 Number of domestic applications for banking licenses		3
1.9.1 Number denied		0
1.10 Number of foreign applications for banking licenses		0
1.10.1 Number denied		
1.11 Basis for denial of applications	1.11.1 Capital amount/quality	
	1.11.2 Banking skills	
	1.11.3 Reputation	
	1.11.4 Incomplete application	

2-Ownership		Morocco
2.1 Is there a maximum percentage of capital that can be owned by single owner?		No
2.1.1 If yes, what is it?		
2.2 Can related parties own capital in a bank?		Yes
2.2.1 If yes, what is the maximum percentage?		None
2.3 Regulatory restrictiveness of ownership by nonfinancial firms of banks		Unrestricted
2.4 Fraction of capital in 10 largest banks owned by conglomerates		Non reported
2.5 Can non-bank financial firms own shares in banks?		Yes
2.5.1 What are the limits?		None
2.6 What is the 5-bank concentration ratio (%)?		75
3-Capital		**Morocco**
3.1 Minimum capital-asset ratio requirement (%)		8
3.1.1 Is it risk-weighted in line with Basle guidelines?		Yes
3.2 Does the ratio vary with a bank's credit risk?		No
3.3 Does the ratio vary with market risk?		No
3.4 Actual risk-adjusted capital ratio (%)		13.10 as of Jun 30, 1999
3.5 Is subordinated debt allowable (required) as part of capital?		Yes
3.6 What fraction of revaluation gains is allowed as part of capital?		None
3.7 Percentage of banking system's assets in banks that are 50% or more government owned		23.9
3.8 Percentage of banking system's assets in banks that are 50% or more foreign owned		18.78
3.9 Before minimum capital adequacy is determined, which items are deducted from capital	3.9.1 Market value of loan losses	Yes
	3.9.2 Unrealised securities losses	Yes
	3.9.3 Unrealised foreign exchange losses	Yes
4-Capital		**Morocco**
4.1 Securities		Permitted
4.2 Insurance		Prohibited
4.3 Real estate		Prohibited
4.4 Regulatory restrictiveness of bank ownership of nonfinancial firms		Restricted
5 & 6-Audit, management, org		**Morocco**
5.1 Is an external audit compulsory?		Yes
5.2 Are there specific requirements for the extent of audit ?		No
5.3 Are auditors licensed or certified?		Not yet but a circular is being drafted
5.4 Is auditor's report given to supervisory agency?		Yes
5.5 Can supervisors meet external auditors to discuss report without bank approval?		Yes

5.6 Are auditors legally required to report misconduct by managers/directors to supervisory agency?		Yes
5.7 Can legal action against external auditors be taken by supervisor for negligence?		No
5.8 Has legal action been taken against an auditor in last 5 years?		
6.1 Can supervisors force banks to change internal organizational structure?		No
6.2 Has this power been utilized in last 5 years?		
7-Liquidity		**Morocco**
7.1 Are there guidelines for asset diversification?		No
7.2 Are banks prohibited from making loans abroad?		No
7.3 Minimum liquidity requirement (%)		60%
7.4 What interest is paid on reserves?		Not remunerated
Minimum reserve requirement (%)		10%
How is reserve requirement remunerated		Not remunerated
7.5 What assets satisfy liquidity or reserve requirements?		Government bonds, assets with banks, some of the debt securities, "actifs mobilisables auprès des banques"
8-Depositor		**Morocco**
8.1 Is there an explicit deposit insurance scheme?		Yes
8.1.1 Is it funded by the government, banks or both?		Both
8.1.2 Ratio of accumulated funds to total bank assets		0.0029
8.1.3 Insurance limit per account		MAD 50,000
8.1.4 Is there a limit per person?		Yes
8.1.4.1 Amount of limit		MAD 50,000
8.1.5 Does deposit insurance authority make the decision to intervene a bank?		No
8.1.6 If no, who does?		The Minister of Finance
8.1.7 If yes, does the deposit insurance authority have the legal power to intervene/takeover a troubled (not insolvent) bank?		
8.2 As a share of total assets, value of denominated debt liabilities not covered by explicit/implicit savings protection scheme?		0.0582
8.3 Number of banks merged/closed (as part of failure resolution) in last 5 years		0
8.4 Were depositors wholly compensated the last time a bank failed?		No
8.4.1 Average time to pay depositors in full		Not reported
8.4.2 Longest that depositors waited in last 5 years		Not reported
8.5 Were any deposits that were not covered at the time of failure compensated when bank failed?		Not reported
8.6 Can deposit insurance agency take legal action against bank directors/officials?		No
8.7 Has the deposit insurance agency ever taken any legal action against bank directors/officials?		

9-Provisioning		Morocco
9.1 Is there a formal definition of "non-performing loan"?		Yes
9.1.1 If yes, what is it?		Not reported
9.2 Classification of loans in arrears:	9.2.1 Substandard	Not reported
	9.2.2 Doubtful	Not reported
	9.2.3 Loss	Not reported
9.3 Minimum required provisioning of loans as they become:	9.3.1 Substandard	20
	9.3.2 Doubtful	50
	9.3.3 Loss	100
9.4 Other classification systems		
9.5 Ratio of non-performing loans to total assets (%)		0.07 (as of end Dec 1998)
9.6 If one loan is non-performing, are other loans of a multiple-loan customer classified as non-performing?		Yes
10-Disclosure		**Morocco**
10.1 Does income statement contain accrued but unpaid interest/principal while loan is performing?		Yes
10.1.1 Does income statement contain accrued but unpaid interest/principal while loan is non-performing?		No
10.2 Number of days in arrears after which interest income cease to accrue		Up to bank's discretion
10.3 Are consolidated accounts covering bank and any non-bank financial subsidiaries required?		Yes
10.4 Are off-balance sheet items disclosed to supervisors?		Yes
10.4.1 Are off-balance sheet items disclosed to public?		Yes
10.5 Must banks disclose risk management procedures to public?		No
10.6 Are directors legally liable for erroneous/misleading information?		Yes
10.6.1 Have penalties been enforced?		No
10.7 Do regulations require credit ratings for commercial banks?		No
10.7.1 What percentage of top ten banks is rated by international credit rating agencies?		40
10.7.2 What percentage of the top ten banks are rated by domestic credit rating agencies?		
10.7.3 Which bank activities are rated?	10.7.3.1 bonds	Yes
	10.7.3.2 commercial paper	Yes
	10.7.3.3 other	Yes
11-Discipline		**Morocco**
11.1 Are there any mechanisms of cease-desist type orders whose infraction lead to automatic imposition of civil & penal sanctions on banks directors & managers?		Yes
11.2 Can the supervisory agency order directors/ management to constitute provisions to cover actual/potential losses?		Yes
11.3 Can the supervisory agency suspend director's decision to distribute:	11.3.1 dividends	Yes
	11.3.2 bonuses	Yes
	11.3.3 management fees	Yes

11.4 Any such actions taken in last 5 years?		Yes
11.5 Which laws address bank insolvency?		Banking Act
11.6 Can the supervisory agency supersede bank shareholder rights and declare bank insolvent?		Yes
11.7 Does banking law allow supervisory agency to suspend some or all ownership rights of a problem bank?		Yes
11.8 Does the law establish pre-determined levels of solvency deterioration which forces automatic actions such as intervention?		No
11.9 Regarding bank restructuring & reorganization, can supervisory agency or any other govt. agency do the following:	11.9.1 supersede shareholder rights	Yes
	11.9.2 remove and replace management	Yes
	11.9.3 remove and replace directors	Yes
	11.9.4 forbear certain prudential regulations	Yes
	11.9.5 insure liabilities beyond any explicit deposit insurance scheme	No
11.10 Number of banks closed in last 5 years		0
11.10.1 Percentage of total bank assets accounted for by these banks		
12-Supervision		**Morocco**
12.1 Bank Supervision Authority		Bank Al-Maghrib
12.1.1 Is there more than one supervisory body?		No
12.2 To whom are supervisors accountable?		Governor Bank Al-Maghrib
12.2.1 How is head of supervisory agency/other directors appointed?		Board of Bank Al-Maghrib
12.2.2 How is head of supervisory agency/other directors removed		Board of Bank Al-Maghrib
12.3 Any important differences between expectations from supervisory agency and what is mandated by law?		None
12.4 Total number of professional bank supervisors		60
12.4.1 Number of professional bank supervisors per institution		3
12.5 Num. of onsite examinations per bank in last 5 years		11
12.6 Total budget for supervision		Not reported
12.7 Frequency of onsite inspections conducted in large & medium size banks (annually=1; every two years =2)		Every three years
12.8 Average tenure of a supervisor (years)		Not reported
12.9 Frequency of supervisors employed by banking industry subsequent to retirement (never=0, rarely=1, occasionally=2; frequently=3)		2
12.10 Must infraction of any prudential regulation found by a supervisor be reported?		Yes
12.11 Any mandatory actions in these cases?		Yes
12.12 Who authorizes exceptions to such actions?		The Governor
12.13 Number of exceptions granted last year		Not reported
12.14 Are supervisors legally liable for their actions?		No

Source: World Bank web site

COUNTRY REPORT - PAKISTAN

BACK TO THE BASICS?

1. DEVELOPMENT PERFORMANCE

Pakistan is now a little more than 50 years old being one of the largest populated countries in the world. Pakistan's development has been shaped by several wars with India, different military regimes and the reliance on foreign aid to fund its deficits.

1.1 Economic performance

Since independence Pakistan's economy has grown at a rate (5% on average) superior to that of the population, which is remarkable given the shocks that it has had to absorb.

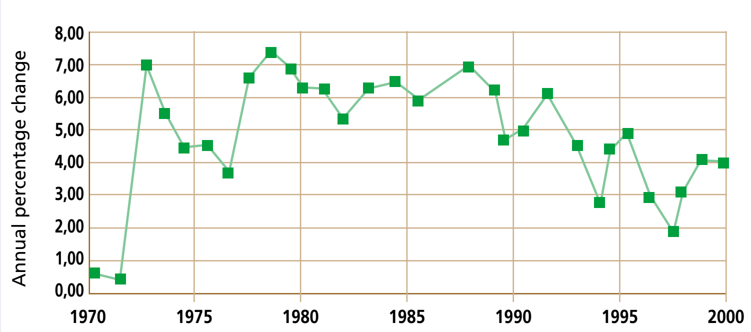
During the 60s the military regime of general Ayub Khan continued the industrial development policy initiated by the Federation (see Appendix 1). The large-scale manufacturing sector grew at more than 9% during the period and Pakistan became a dominant exporter of manufactured goods in Asia. Despite the war with India in 1965, GNP growth rates were on average about 6% in the period.

Pakistan suffered an attempt of democracy under the socialist government of Z. Bhutto between 1971-1977. A broad restructuring of the economy under an ambitious set of populist and socialist oriented reforms took place in this period. But the effect remained limited, and the agriculture sector stagnated due to a combination of exogenous and policy factors, including low output prices. Balance of payments difficulties in part due to the oil shocks led to substantial borrowings abroad (both public and private) and a growing dependence on foreign savings. Growth was about 5% during the Bhutto period (see exhibit 1). Most growth took place in the construction and trade sector – manufacturing and agriculture were sluggish at 2.5-3.5% on average.

General Zia ul Haq (1977-1988) showed a return to centralized political power, and an attempt to Islamise the society. The 80s saw a reversal of the public-led sector growth strategy, and growth was a respectable 6% during the decade, but fiscal sector deficits increased and averaged 8% of GDP in the late 80s. They were caused mostly by increases in current and defence expenditures, and led to increased borrowing domestically, which would have serious repercussions for public finances and macro-economic stability in the 90s.

REAL GDP GROWTH IN PAKISTAN

Exhibit: 1



Source: IMF, World Bank

CENTRAL GOVERNMENT FISCAL BALANCE AND EXTERNAL DEBT (% OF GDP)

Exhibit: 2

	70s	80s	1990-95	1995-99	2000	2001
Govt deficit (-) / surplus	-7.5	-6.5	-7.2	-6.9	-5.9	n.a.
External debt	48.0	36.8	47.9	51.4	56.2	64.0

Source: World Bank development indicators, IMF, OECD

Pakistan saw the return to elected governments in 1988 – a third attempt at democracy – but the two dominant parties (Muslim League and People's Party of Pakistan –PPP)[114] jockeyed incessantly for power. This political instability resulted in lower business confidence and smaller private investment. Total investment fell from about 18% of GDP in the early 90s to 13% in 2000. A number of reform programmes were started, focusing mostly on the trade and financial sectors, and on industry, and a first wave of privatisation took place. However, the reforms could not be sustained. The decade saw a continuation of the fiscal deficit around 6%, and an increased dependence on aid as remittances flows decreased, and private flows after a spur in the early 90s reduced to very little later. None of the nine IMF-supported reform and adjustment programmes initiated during that period was completed, and the credibility of Pakistan vis-à-vis the donors progressively eroded.

In 1999, Pakistan's economic situation was near the collapse: permanent fiscal deficits resulted in an unsustainable level of debt, lack of private investor confidence and very low level of reserves of Pakistan. External debt in 1999 accounted for 56% of the GDP (see exhibit 2).

Due to Pakistan's urgent situation, the military government that took office 1999 rapidly launched a comprehensive reform programme that attempted to address the issues of governance, slow growth, social gaps and the heavy debt burden. While some of these reforms had been attempted before, these had been partial and issues of corruption; weak institutions and governance were not put at the forefront of the reform, as they appear to be now. This programme is supported by the IMF, who initially approved a Standby Credit (one year) of US$600 million (November 2000), and later, upon successful execution of the programme, approved in December 2001 a three-year Poverty Reduction and Growth Facility (PRGF) amounting to about US$1.3 billion. The first review under this PRGF, in March 2002, concluded that the overall programme was on track – although growth prospects had to be scaled down and tax revenue was lower than expected. Other donors have supported the programme with substantial assistance[115]. In December 2001 the Paris Club agreed to a major debt-restructuring workout (see unattainable debt burden section).

114 The PPP is dominated by landlords and has a strong base in rural areas. The Muslim League is more linked with urban classes and industrialists
115 Adjustment operations by the World Bank/IDA (US$300 million for banking sector restructuring) and by the Asian Development Bank (US$330 million for reform of the judicial system).

MAIN TRADE INDICATORS IN PAKISTAN

Exhibit: 3

	1998/99	1999/2000	2000/01	2001/02 (proj)
Merchandise exports/GDP (%)	12.8	13.3	15.0	14.9
Merchandise Imports/GDP (%)	16.4	15.6	17.1	16.4
Total trade/GDP (%)	29.2	28.9	32.1	31.3
Trade balance/GDP (%)	-4.4	-2.3	-2.1	-1.5

Source: IMF, World Bank

The core of the government's reform agenda, described in detail in Pakistan's Interim Poverty Reduction Strategy Paper, focuses on six areas: governance, investing in people, macroeconomic sustainability, the financial sector, the investment climate for the private sector, and agriculture and irrigation. The current reform programme envisages that growth will progressively resume at rates closer to those registered earlier. It forecasts GDP growth at 5.2% in 2003/04, which is equivalent to the average rate enjoyed by Pakistan since independence (for details see appendix 1).

Fiscal and monetary policies

High and constant fiscal deficits in the past, at around 6-7% of GDP for many years, caused the accumulation of debt noted above. Inflation could be contained because of good management on the monetary side.

All IMF-supported programmes in the past had attempted to reduce this unsustainable deficit, but failed successively. The main reasons are that on the revenue side the tax base is narrow and tax administration not efficient. Excluding grants, budget revenues have stayed around 16-17% of GDP in the last decade, while expenditures have been around 22-23%. This permanent gap of 6-7% is difficult to reduce. First, development expenditures that have been severely constrained over the years, falling from 10% of GDP in the early 80s to about 3% in 2000, can hardly be squeezed further. Second, interest payments have progressively increased and now are nearly half of current revenues, or 8% of GDP. The third element concerns military expenditures. While they have been reduced by 1-1.5% of GDP in recent years, they still account for close to 5% of GDP, a very high level[116]. Reducing these expenditures would be highly desirable, but assumes that there is a permanent peaceful solution to the Kashmir issue, which does not appear evident in the short term. In addition, events in Afghanistan have probably added costs as Pakistan had to mobilize troops and equipment on the Western border and it is not clear how long this effort will have to be maintained. Clearly, reduction of tensions in the region will be a major contributor to the ability of Pakistan to better come to grips with its fiscal balance.

The present programme forecasts that the budget deficit will progressively be reduced to well-below the levels of the 90s. By 2003/04, according to the programme supported by the IMF, the budget deficit would be 3.3% of GDP.

The unsustainable debt burden

By 2000, total public debt was about US$61 billion, i.e. about 100% of GDP, and divided 44:56 between rupee and foreign debt. Debt to the Paris Club was 35% of foreign debt, with about a third at commercial terms and the rest at ODA terms. Multilateral debt to the IMF, the World Bank and the ADB, comprised 43% of external debt. External debt servicing was absorbing 37% of export earnings, and total debt servicing represented 68% of tax revenues, 57% of total revenue, or 49% of current expenditure. This was clearly an unsustainable situation.

In December 2001 the Paris Club agreed to a major debt-restructuring workout considering the whole debt stock that would provide gross cash flow relief of about US$3.6 billion during the programme period (up to mid 2004). This provides some much-needed breathing space for Pakistan and should be of great help for the implementation of the sustained implementation of the programme.

The current government appointed a task force to review in detail this problem and proposed a strategy. The conclusions and recommendations of the report were used for the preparation of the IMF-supported programme, which under a set of macro-economic and other assumptions, plans that the external public debt would progressively be reduced to 48% of GDP in 2003/04, and debt servicing would be below 30% of exports of goods and services by that year.

1.2 Trade – a reasonable performance

Pakistan has developed a reasonably efficient and dynamic trade sector. The foreign trade/GDP ratio, about 15% in 1960, increased to about 35% in the early 90s, and has remained stable since then at 30% or more. Commodity exports, that represented more than 90% of exports at time of independence, decreased progressively to about 15%, and the proportion of exports of manufactured products has increased to more than 60% since the mid-90s.

This respectable performance has been the result of deliberate export-supporting policies in the 60s combined with a set of measures supporting import-substituting industries. In the early 90s, a series of reforms was introduced to liberalize the economy. Average import tariffs were reduced swiftly from 70 to 50%, industrial licensing was abolished, and the foreign investment regime was liberalized. Pakistan's average tariffs further declined to just above 20% - a level that is still above other countries with which Pakistan competes in world markets for labour-intensive industries.

Exports in Pakistan are concentrated in textiles and clothing, which now account for about 80% of the country's exports. This concentration on one industry, which is benefiting from the availability of local cotton supply, is somewhat risky as it depends upon the willingness of industrialized countries (that now are the major destination of Pakistan's exports) to continue opening their markets and in particular on implementing forcefully the Multifiber Agreement. Under this situation, some diversification of exports would be advisable, and the government's intention to reduce effective protection through the phasing out of statutory regulatory orders (SRO) is a positive step. While Pakistan has progressively reduced its import tariffs, these are still above many other Asian countries, and the SRO practice has resulted in maintaining inefficiencies in some sectors (steel, polyester fibres and fabrics).

On the import side, as a result of the import substituting policy, the proportion of imports of consumer goods decreased progressively from about 40% in the late 50s to about 15% now, with imports of capital goods and raw materials increasing and remaining stable at around 80% of total imports.

Pakistan's trade balance has remained negative over the last few years, although the deficit has decreased (see exhibit 3). This is partly due to the deceleration of growth, and perhaps also to fewer imports of capital goods given the low investment patterns in both the public and private sectors.

116 It is always difficult to estimate such expenditures. The figure quoted includes pension costs. A comparison with India is difficult for many reasons, including the fact that change of technology from Russian to Western equipment in India has progressively increased the cost, and that India typically does not include pension costs in its calculations. Even if an underestimate, the figure of about 3% for India indicates that the cost of military expenditures is a higher burden to Pakistan.

1.3 Development aid

Official aid flows

Net official financing flows in Pakistan as a proportion of GNP have been above those for the South and Central Asia region as a whole and for developing economies for most of the study period, as the graph in exhibit 4 indicates.

Within that period, the proportion of multilateral aid increased progressively and is now about 60% of flows. Among bilaterals, the contribution of all donors decreased over time, except for Japan (refer to exhibit 5).

Allocation of Aid

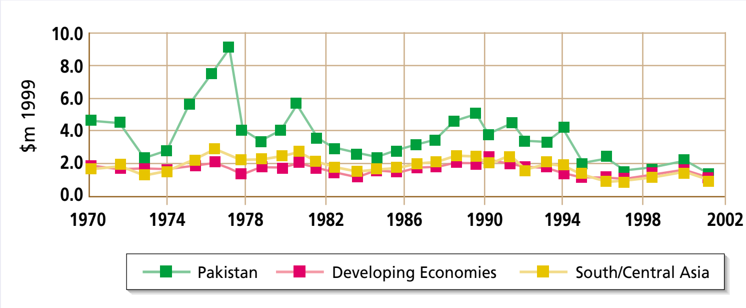
While statistics on the distribution of aid between investment and balance of payments/reform support are not known, a cursory review of major programmes shows that as for many countries the movement has been out of traditional infrastructure projects and support to industry to emphasis on social sectors and support on reform. In the case of Pakistan, however, energy and agriculture/irrigation have continued to figure prominently as sectors of support even in recent years, although the content of operations in those sectors has also evolved toward reform and institutional building rather than pure investment.

Private flows

Private flows stayed at a low level until the beginning of the 90s when Pakistan, with support donors, embarked on a policy to attract private investment for power generation. That policy was successful (see appendix 2) and about 7,500MW of new power generation was installed between 1993 and 1998. At an average cost of US$1 million per MW, this is equivalent to US$7.5 billion of investment. If one assumes that about 60% of that cost was funded by equity and debt from abroad, that would be equivalent to about US$4.5 billion of private flows to Pakistan, i.e. close to 80% of total private flows during that period, were related to this energy programme (see exhibit 6). Unfortunately accusations of corruption during the programme's implementation combined with a deteriorating political and external situation, led to private flows being minimal after the policy was stopped. This happened at a time when overall investment in Pakistan was decreasing – total investment as a share of GDP went down from around 18% of GDP at the beginning of the 90s to around 13% by 2000, reflecting declines both in the public sector and in private investment.

COMPARISON OF NET AID FLOWS

Exhibit: 4



Source: DAC - OECD Online Database

DONOR DETAILS - NET OFFICIAL DEVELOPMENT ASSISTANCE, (US$m 1999)

Exhibit: 5

	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
EU members	410.5	279.0	182.4	272.5	217.4	105.1
Japan	165.0	157.7	226.7	245.0	202.3	257.1
UK	86.7	78.0	55.5	46.3	46.4	52.0
US	482.3	268.5	125.2	274.0	76.5	-47.6
Other	88.3	131.9	75.6	66.2	37.1	24.2
Total	1232.8	915.2	665.4	903.9	579.7	390.8

Source: Compiled From OECD DAC Online Database

NET PRIVATE FLOWS

Exhibit: 6

	70s	80s	1990-94	1995-98	1999
Net Private flows (US$ million, 1999)	145,2	265,8	1,203	1,848	52.5

Source: OECD DAC online Database

Role of aid and its effectiveness

Pakistan is a clear example of aid dependency, having extensively relied on foreign savings (aid and remittances) to fund its deficits while maintaining an intimate relation with donors. A review of aid trends shows swings associated with changes in US-led regional policy considerations. Flows increased substantially during the "liberation" war of Afghanistan (1981-89), were subsequently reduced, stopped altogether following Pakistan's exploding of a nuclear device in 1998 and resumed strongly after the current military regime sided with the US in its fight against terrorism.

The World Bank also played a major contributing role in helping Pakistan and India come to an agreement on the Indus Basin water system, which paved the way for developing the dam and irrigation network in the basin, contributing both to the creation of large hydropower resources and development of irrigated agriculture. This, coupled with the fact that Pakistan was the first country where the World Bank established a resident mission (1956), explains why relations between donors (in particular the World Bank) and Pakistan have led to a continuous dialogue at the highest level, accompanied with substantial financial support. Pakistanis have also been successful at managerial levels in multilateral institutions, which helped in fostering the dialogue and provision of advice. Conversely, a number of Pakistani staff from IFIs has returned to Pakistan, some to high positions, reinforcing the ties[117]. This has brought benefits to both Pakistan and the IFI concerned, but may also have blurred to some extent the "ownership" of some programmes. Finally, this high recourse to aid over the years, combined with the inability to tackle the endemic fiscal problems and little success in diversifying its external funding out of the official flows, resulted in Pakistan developing a high dependency on aid – as indicated above, 43% of its external public debt is owed to multilaterals, and 36% to the Paris Club and other bilaterals. This is certainly

117 M. Qureshi, former executive VP of the WB/IFC, was prime minister of Pakistan ad interim in 1993. Another VP from the World Bank joined temporarily the 2nd N.Sharif government as minister of finance. The current governor of the Central Bank, the Deputy Chairman of the Planning Commission, and the Minister of Finance of the Sindh province, are all former World Bank staff. A number of other former staff have contributed to the preparation of some parts of the current reform programme, including taking the lead of various commissions.

a much higher proportion than most other Asian countries of this size or larger (with the exception perhaps of Bangladesh).

Politics and volatility

While Pakistan has made much use of aid and assistance from donors, flows have often been irregular because of politics, either internal, or external. Evidently wars with India have interrupted aid commitments in the past, and frequent changes of governments in the 90s have also introduced some stop and go cycles in aid commitments, all the more since a larger part of aid was directed towards reform and adjustment, which requires steady management. Thus the pattern of commitments in the 90s reflects a three-year cycle linked to the cycle at which governments were formed and dismissed. The disbursement patterns reflect this cycle much less because of the slower disbursement on investment loans and technical assistance. However this cycle has introduced an element of volatility in aid flows.

The other element of aid volatility reflects the external political aspects of support to Pakistan linked to the situation in the region, in particular events in Afghanistan, and, indirectly, Kashmir. Following the Russian invasion of Afghanistan in 1981, Pakistan, then under military rule, sided with the US and received a large package of military and economic aid from the US. This particular assistance was stopped in 1990 after Russia left Afghanistan, when the US President decided to no longer certify that Pakistan had not developed a nuclear capacity, and the USAID mission, that had been managing a very large programme of assistance, was closed. A similar situation happened following the September 11 events, when General Musharraf decided to support the US-led fight against terrorism and provided intelligence services and troops to help in the Afghan war. At that time the US and other industrial countries decided to (temporarily) eliminate the sanctions that had been put in place following the explosion of nuclear devices by Pakistan. As the same countries have a large majority in the multilateral financing institutions, multilateral aid also evolved to reflect these political developments, to a large extent. Given Pakistan's dependency on aid (much greater than India's), volatility of flows for either internal or external political motives has become a factor to be taken into account in managing the future.

Effectiveness of aid

The issue of aid effectiveness is hard to analyse, and can be best appreciated when looking at specific cases. Overall it seems that Pakistan has used aid effectively, particularly in the early years. However the progressive, partial shift to balance of payments support for reform programmes that did not fully meet their objectives resulted in less overall effectiveness in the later years, as debt was accumulated with little result. In addition, at times aid-funded programmes or projects did not reach their objectives and resulted in debt being accumulated with little return. The above-mentioned example of an innovative programme to boost private investment in the energy sector, much supported by all donors, is one such example of a programme yielding much lower than expected returns, and with a longer term negative return because of the adverse effect on private sector confidence. Another example, described further in this document (see section 1.4), concerns the social sectors. A major effort by Pakistan and the donors to address the main issues in the social sectors resulted in very little being achieved, mostly because of the very weak administrative capacity to implement a complex and multi-faceted programme at the local government level.

Aid and NGOs in Pakistan

The NGO sector in Pakistan is well developed, accounting for at least 5,000 active NGOs. It is recognized by the donors and the government that NGOs are actively contributing to poverty reduction in rural and urban areas. Overall, the NGO sector in Pakistan, in terms of numbers, has grown rapidly in the last two decades. Even a modest estimate indicates that there are close to 10,000 NGOs in the country, of which at least half are active. Approximately 70% of these NGOs are located in urban areas and 30% in rural areas – in inverse relation to the population and poverty distribution. More than half are working at the community level, 25% at the district and tehsil (sub-district) level, and about 2% at national level. Most of the NGOs are welfare-oriented. The largest numbers are single-community or village-based groups run by volunteers, with minimal administrative structures.

NGOs obtain legal status to qualify for financial assistance from government agencies, open a bank account in the name of the NGO, sign contracts, and offer personal indemnity to its members. Their capacity to deliver development initiatives, nonetheless, remains limited. However, the growth of support organizations and the initiatives being undertaken by them are helping develop capacity within smaller organizations to undertake a larger development and economic agenda. A majority of NGOs depends upon donor funds to cover operating and overhead costs. Rural support programmes also receive substantial support from the government.

One of the first (and internationally-renowned) NGO projects was the Orangi Pilot Project around Karachi, which was developed in the 70s by a remarkable pioneer Akhtar Hameed Khan. It initially focused on developing self-help, low-cost schemes for poor people in the suburbs of Karachi for water and sanitation, and later developed such community-based schemes for education, health, employment and micro-credit, particularly for women. The population in Orangi is about 1 million. The project is considered to be a model for community self-help successful development.

This initiative was replicated by a disciple of A. K. Khan in the Northern territories, through the development of the Aga Khan Rural Support Programme, established by the Aga Khan foundation, which has been recognized internationally as a major success in terms of improving the quality of life of people in these highly constrained areas – incomes have doubled over the first ten years of the programme, and savings rates in this population are much higher than in Pakistan as a whole.

The experience gained in these programmes led to the establishment of the National Rural Support Programme (NRSP) that has a national coverage and operates directly or through associated rural programmes, linked through a network, in 82 districts in Pakistan. By mid-2001, this network was assisting about 30,000 village organizations regrouping about 700,000 members, and was expanding fast.

Relations between the NGO and the government (and donors) have not always been easy, but have improved substantially over time and are relatively good at present. NGOs now appear to be a well-accepted channel for both the government and donors to contribute to poverty reduction in rural and urban areas. The previous government had created a Poverty Alleviation Fund that supported programmes of effective NGOs – in particular for local infrastructure and micro-credit. The fund has been well funded by various donors, including the World Bank (Credit of US$90 million in 1999). In parallel, as a major and ambitious initiative, the Kushhali Bank was created with government support and that of the ADB to contribute to poverty uprooting through the provision of micro-credits throughout the country, in collaboration with the rural support programmes.

In the context of the devolution programme (see below), efforts are taking place between the NGOs, and in particular the Rural Support Network, and the government to develop the capacity of local governments to manage public services at the local level with some contribution of the users.

There are also direct government programmes to help the poor, among which the Zakat fund is the largest. It is funded through a 2.5% tax on bank savings, but the operations of that fund have been affected by management problems.

1.4 Poverty reduction

Poverty continues to be an endemic problem in Pakistan. It had risen in the 60s and decreased in the 70s and 80s, but still about a third of the population lives in poverty today[118]. Income distribution followed a similar pattern – but worsened further in the 90s.

Programmes to attack poverty

In the early 90s, Pakistan launched a comprehensive programme to address issues in the social sectors – the Social Action Programme (SAP). It was extremely ambitious (see appendix 3) and produced little results. The current government has now developed an overall programme to reduce poverty within the context of a wide-ranging reform programme. This programme is embodied in the Interim Poverty Reduction Strategy - analysed further in this document. Fundamentally, the government of Pakistan believes major changes in governance (legal, political, financial, administrative aspects) are necessary to empower people and reduce poverty. In addition the government is pursuing some specific programmes (e.g. the Poverty Alleviation Fund supra) to directly assist the poor.

Within the Poverty Reduction Strategy elaborated by the current government, improvements in the delivery of social services appear prominently as a top priority. The Interim Poverty Reduction Strategy Paper (I-PRSP) describes the devolution programme as the main vehicle to improve access to education, health, and other public services. It also attempts to address the shortcomings that affected the implementation of the SAP.

The key components of the strategy to improve education include an overall framework – an Education Sector Reform, launched in 2001 – that lays the foundation for meeting the objectives of the Education for All programme. Other elements are: a major school rehabilitation programme, a teacher-training programme, Learning Centres at the district level, the development of further public-private partnerships for low-cost private education through funding education foundations, and the establishment of a National Education Assessment programme. As education is essentially a provincial issue, participation of provinces in the reform is essential. It appears that there is a broad consensus on the matter, and federal and provincial authorities have signed MOUs linking resource transfers to improvements in education outcomes.

As to health, the strategy is to raise public sector health expenditures and focus on prevention and control programmes. In addition, the government envisages to expand the Lady Health Workers programme (that trains village women to provide basic primary health care) as it has been very successful since it was started in 1994. Again, improving access to health is closely linked to improvements at the local level through the devolution programme, and two of the four provinces (Punjab and NFWP) have already started strengthening the management of social services at the district level, including decentralizing staff from the centre.

It should also be mentioned that the government has shown a new concern regarding gender equity. An independent Permanent Commission on the Status of Women was created in July 2000, to review the laws and regulations affecting women's rights. Based on its work and after extensive consultations, a number of laws were redrafted to make them more gender sensitive. They include the Family Ordinance and Rules, the Marriage License Act, the Family Court Act, the Dissolution of Muslim Marriages Act, and the Child Marriage Restraint Act. Unfortunately, up to now the conservative religious lobby has prevented the enactment of these reforms. As indicated earlier, the representation of women in the governments will be increased. In addition to 30% of seats in the local governments reserved for women, the number of seats reserved for women in the future National Assembly will be increased from 20 to 60.

SOCIAL INDICATORS - PAKISTAN 1975, 1985, 1995, 1999

Exhibit: 7

	1975	1985	1995	1999
Infant mortality rate (per 1,000)	134	122	99	90
Life expectancy at birth (in years)	52	57	61	63
Primary school enrolment rate (in %)	39.5	43.7	n.a.	n.a.
Secondary school enrolment rate (in %)	14.7	17.2	n.a.	n.a.
Adult illiteracy rate (in %)	75.8	68.2	58.8	55
Immunization DPT (% children under 12 months)	n.a.	30	58	80

Source: Compiled from World Bank Development Indicators

COMPARATIVE PERFORMANCE, 2000

Exhibit: 8

	Pakistan	South Asia	LDCs
Population (million)	138.1	1,355	2,459
GNI (Atlas method, US$ billion)	61.0	617	1,030
GNI per capita (atlas, US$)	440	460	420
Poverty (% population below national poverty line)	33	n.a.	n.a.
Urban population (% of total)	37	28	32
Infant mortality rate (per 1,000)	90	74	77
Life expectancy (years)	63	63	59
Access to improved water source (% of population)	88	87	76
Adult illiteracy rate (% of population)	54	45	38
Gross primary enrolment (% school age population)	69	100	102

Source: World Bank

Social indicators

Pakistan lags behind other countries with similar income levels on almost all social indicators, and its public spending on health and education, about 3.5% of GDP, is also lower than it should be. While Pakistan has succeeded to grow faster than many low-level countries, despite a high population growth rate (now about 2.4%), it was not able to achieve the same progress in the social sectors (see exhibits 7 and 8). Pakistan ranked 127th out of 162 countries on the Human Development Index in 1999. Gender disparities are more pronounced in Pakistan than in most other countries. This social gap is likely to continue affecting Pakistan's ability to sustain growth and development.

2. INSTITUTIONAL INFRASTRUCTURE

2.1 The political system
(Overall rating 3)

2.1.1 The Rules

Pakistan's political history has seen many changes in the past 50 years. The constitution has been suspended each time a military ruler took over, and the record of civilian governments has been questionable.

118 According to some figures the situation would have worsened in the late 90s.

Pakistan's current constitution, based on English common law with specific provisions to accommodate the country's status as an Islamic state, dates from 1973, after East Pakistan (now Bangladesh) seceded. Several amendments were introduced over time, among which one to allow for referendums (during Z. Bhutto's regime), and another to give extraordinary powers to the President (dismiss the government, appoint governors and military chiefs), that was introduced by Zia ul Haq. It was removed in 1998 during N. Sharif's second government. The constitution is suspended at present.

General Musharraf, who led the coup in 1999 and became President of Pakistan, obtained by referendum a five-year term as President. He announced a plan to change the constitution to organize differently the relations between the President and the Prime Minister that would be appointed out of parliamentary elections planned for October 2002 before Pakistan is to return to civil rule. To a number of Pakistanis, the current situation resembles those which occurred at the start of previous military regimes, and there remains therefore a question mark as to whether the deep reform programme presently under execution would be institutionalised and lead to Pakistan to better manage its affairs in the coming century, or whether history would repeat itself.

2.1.2 The Structure

Pakistan is a federal republic. Administratively it is comprised of four provinces[119], of which Punjab is by far the largest, accounting for 60% of the population, plus one capital territory and Federally Administered Tribal territories. In addition, the Pakistani-administered portion of the disputed Jammu and Kashmir regions includes Azad Kashmir and the Northern Areas.

The two major political parties are the Muslim League, dominant in urban areas and the Pakistan People's Party (PPP), which dominates in rural areas with a particularly strong base in Sindh. Political alliances in Pakistan have shifted frequently in the past, and the constant jockeying for power and access to resources in the last ten years of the leaders of these parties (N. Sharif and B. Bhutto) resulted in mismanagement and corruption. At present, the parliament is dissolved but political parties are allowed to operate. While there is a strong feeling that traditional parties and their leaders have been discredited by their record, the two major parties are still very alive and have strong support in the population, perhaps more because party affiliation has been seen a source of patronage and access to employment or to public resources than because of clear political agendas or the charisma of their leaders. If anything, the Muslim League and the PPP share some basic consensus on economic policy. There are other, rather small parties, which at times have played a relatively important role, as their support was crucial for the two larger parties to win elections. This may also explain why small, extremist, religious parties have exerted influence out of proportion with the size of their electorate - particularly in times of tension regarding Kashmir, or during the Taliban regime in Afghanistan. To some extent, this is also a consequence of the Islamisation programme of Zia ul Haq.

2.1.3 Management

Corruption still remains a key obstacle to improving Pakistan's deteriorated governance. The Pakistan devolution plan launched in 1999 is conceived as the major vehicle to improve governance focusing on the improvement of social and other public services.

The three main power bases in Pakistan have been the Prime Minister, the President, and the Army, with the latter mostly intervening in times of crises. In the beginning, bureaucracy also played a major role (which, according to some, affected the political development of a democratic state).

Pakistan has remained highly centralized administratively, mostly because the federal government collects most taxes and allocates them to the provinces under a system that is revised from time to time to adjust to economic and population changes. While facilitating macro-economic management, this may have been a factor in the lack of accountability at the provincial level.

The system has been abused by the political parties and by private interests. As a result there has been a capture of rents and access to resources by elitist groups (feudals, tribal leaders, industrialists, bureaucrats…), corruption has become pervasive, and Pakistan has suffered from a crisis of governance. The previous government's 2010 Vision Statement noted that "corruption… pervades all three branches of government: the legislative, the judicial and the executive". Pakistan was ranked 71st out of 91 countries in the corruption index of Transparency International.

The constitution of Pakistan does not deal specifically with local governments (mostly districts) that have been in existence sporadically in the past depending on the whims of the provincial politicians. A lack of capacity at the local government level has at times been used as an excuse to provincialise functions initially assigned to local governments, whose finances have atrophied.

Shortly after taking power in late 1999, general Musharraf announced a very ambitious plan to devolve political and fiscal central powers to a series of new local governments, and instructed the National Reconstruction Bureau to launch this initiative. The devolution plan is conceived as a major vehicle to improve governance within the delivery of social and other public services, with more participation of the users in the administration and greater monitoring of the services.

The new system envisages three sets of elected governments along with the provinces: districts (96), tehsils (37), and union councils (6,022). The union councillors (126,000) are directly elected and in turn elect the tehsil and the districts members. A third of the seats in each government is reserved for women. The idea is that the devolution programme will provide a more effective framework to make a government accountable, close to the people, and responsible for the delivery of basic social services – basic education, health, family planning, community infrastructure including rural water, etc.

Improvement in local service delivery will depend on the interplay between the district councils and proposed Citizen Community Boards, which are envisaged as a critical part of the mechanism for improving the delivery of services. Staff performance in the social sectors is to improve through merit-base appointments, training and monitoring.

Elections for each set of the new local governments were held between December 2000 and August 2001, and, with very few exceptions, were fair and impartial. However, 16% of the women's seats are still empty due to lack of candidates.

The devolution plan is one of the boldest both in its breadth and timetable. The next step, organizing the fiscal decentralization, will take a long time to complete, and putting in place the capabilities at the new levels, the monitoring and evaluation[120], the training of the new councillors among other tasks will also require time, persistence and patience. On the fiscal side, Provincial Transition Committees have been set up to draw the budgets for each district,

119 Baluchistan, Sindh, Punjab and the North West Frontier province (NWFP).
120 A sophisticated and computerized monitoring and evaluation system is being prepared by the NRB, and is being tested on sample districts.

and Local Government Ordinances (LGO) have been promulgated in each province to clearly spell out the roles of the three levels of government and the fiscal framework, the checks and balances to avoid elite capture of the local governments. One potential issue is the fiscal cost of the plan that has not been fully estimated, and how its long-term implementation can be fully funded given the shortage of resources in the country.

There is no doubt that this initiative, if successful, will have profound ramifications on the political landscape in Pakistan, and will go a long way in contributing to resolving the very serious governance problems that the country has been facing for some time, and will pave the way for improved social polity. If anything, hopes of improving social service delivery with the new system are well justified given the disastrous experience with the Social Action Programme. After some hesitation, the traditional political parties appear to have played the game, and also after some hesitation, donors have been supporting the plan more and more actively with technical assistance funding and advice. Still, some circles (in particular in the bureaucracy) remain strongly sceptical about this initiative's chances of success.

Reforms in the federal service

Reforms have for the time focused on the federal service, which, while a comparatively small part of the total service, serves as a standard for the provinces. Reforms achieved or agreed today include:

- Strengthening the authority and independence of the Federal Public Service Commission, increasing its financial autonomy and expanding its role in recruitment. Reforms in that area are designed to eliminate the politicisation of appointments. Provinces are now programming similar reforms, with Sindh in the lead.
- A pay and pension reform (December 2001) including a sizeable increase in salaries and significant changes in pensions. Still, salaries remain low, particularly for the higher grades. While pension reform was designed to improve the medium and long-term sustainability of the pension system, a close review will be needed to ensure that this will be the case, in particular for military pensions.
- Rightsizing and restructuring. A series of reforms have been proposed to reduce in stages the ratio of lower-rank staff to higher-graded officers, and to improve managerial flexibility in the service.

It is the first time that a civil service reform of that amplitude is being launched, and correcting the great deficiencies of the past, while well-needed, will take time. Total employment in the public sector was 2.8 million in 1997, according to a World Bank report proposing a framework for Civil Service Reform. Provincial government accounted for 60% of the total, and implementation of the reform at that level is crucial.

Aid Management

The Ministry of Finance is responsible for Pakistan's foreign assistance management. Although corruption is widespread in many parts of the public system, the part of the Ministry of Finance dealing with external aid has a reputation of integrity and effectiveness.

2.2 The Legal Framework *(Overall rating 2)*

2.2.1 The Rules

The 1973 Constitution provides for "separation of judiciary from the executive" and the "independence of judiciary". Qualifications, appointment and removal (only for superior judges) and judges' salaries are laid down in the constitution. Funding of the judiciary comes from federal/provincial budgets (refer to appendix 4 for a summary of the legal and political systems).

At least eight law reform commissions were constituted since 1958 to review the system, but very few of their recommendations were ever implemented. A recent review funded by the ADB documents the various areas of concern, the issues to be sorted out, and possible solutions[121]. Issues relate to: weak governance and administration, long delays (see below the very high number of cases pending), lack of professional management in the courts, lack of client focus, lack of budgetary resources (non-salary expenditures in civil courts are between 4-8% of the budget when they should be in the 15-20% range), inadequate infrastructure, woefully limited disclosure of information, lack of grievance procedures, gender imbalance, and general decline in professional standards and the quality of legal education.

2.2.2 The Structure

There is one Supreme Court, the apex judicial institution, exercising original, appellate and advisory jurisdiction. The judges (17 at present) are appointed by the President from a list submitted by the Chief Justice (the most senior person). The Supreme Court has original jurisdiction in inter-governmental disputes (between federal and provincial governments, or between provincial governments) and in the enforcement of fundamental rights, where an issue of "public importance" is involved. It has appellate jurisdiction in civil and criminal matters. It also hears appeal cases against Federal Shariah Court, Service Tribunals and some special courts. At the beginning of 2000, 8,700 cases were pending, showing the overburden of the court, which also operates through benches in Islamabad, Karachi and Lahore.

Each of the four provinces has a High Court, with one Chief Justice and between six and 50 puisne (subordinate) judges. Judges are to be qualified, and are nominated by submission of proposals from the High Court Chief Justice to the President through the provincial governor and the Chief Justice of Pakistan.

These High Courts have original jurisdiction for enforcement of fundamental rights and appellate jurisdiction in judgments/orders of subordinate courts in civil and criminal matters. Total cases pending at end 2000 were 69,000 in Lahore, 27,000 in Karachi, 15,000 in Peshawar and 700 in Quetta.

One controversial issue has been the transfer of a judge from one court to another, provided for in the Constitution under certain conditions, but "eased" through various amendments by different governments.

Finally the Federal Shariah Court, established in 1980, is comprised of eight Muslim judges (including three ulemas), all appointed by the President for three-year renewable terms. This court examines or determines on its own motion or through petition by citizens or government whether a certain provision of law is abhorrent to Islam. Appeals against its decisions go to the Shariah Appellate bench of Supreme Court (three Muslim judges from Supreme Court plus two ulema appointed by President). The Shariah Court also has revisional jurisdiction over criminal cases for Hudood cases[122].

The subordinate judiciary includes the civil courts (District Judge, Additional District Judge, and Civil Judges Class 1, 2 and 3) and the criminal courts (Session Judge, Additional Session Judge and Judicial Magistrates Class 1, 2 and 3).

Some special courts exist, among which the Revenue Courts (Board of Revenue,

121 ADB- appraisal report on loan for access to justice program November 2001.
122 The Hudood ordinance of 1979 criminalizes extra-marital sex and rape. The Shariah Court has been criticized for some of its judgments tending to restrict the rights of women.

Commissioner and Collector appointed by provincial governments), the Special Banking Courts, Special Custom Courts, Taxation and Anti-Corruption courts, and the income tax (appellate) Tribunal. Judicial officers operating in these courts are appointed on deputation from the provincial judicial cadre.

The backlog of criminal and civil cases at the level of the subordinate judiciary is very high. At the beginning of 2000 there were 340,000 criminal and 440,000 civil cases pending in Punjab, the situation in the other provinces being no better.

Finally, Service Tribunals at the federal and provincial levels exert jurisdiction over terms and conditions of civil servants.

2.2.3 Management

The effectiveness of the judicial system has been repeatedly compromised by political practices, and has not garnered the necessary degree of independence from the executive, particularly in terms of securing adequate and predictable budgetary resources. As a result, confidence of the population in the system is extremely low[123], particularly at the subordinate level.

The current government, under its good governance drive, had recognized the central role that strengthening the rule of law and access to justice will play, and has already taken some actions in that regard. As part of the devolution programme, the office of district commissioner has been abolished to remove concentration of judicial and executive functions at that level. It has appointed local ombudsmen to hold local bureaucracy accountable, and proposes to encourage private dispute resolution through new institutions building on traditional systems as the "panchayat". Also, actions by Chief Justice Committees and the Law Commission have already drastically reduced delays related to family matters, and only cases filed in 2000 are now pending in Family Courts. These various actions are part of a more global reform of the judicial reform programme, called Access to Justice Programme that is supported by the donor community, with the ADB taking the lead, and includes the following:

- improve policy making, end the Commission Ordinance of 1984 and formalize a national judicial policymaking body acceptable to the Chief Justices
- strengthen judicial independence by implementing the separation of the judiciary from executive at all levels (reviewing relevant laws, including planning judicial sector resources in a medium term framework, establishing an Access to Justice Fund (AJF) with separate windows for legal empowerment, judicial development, Federal Judicial Academy, innovation and research, etc.)
- reduce delays by establishing small courts plus local private dispute resolution systems, amend Family Court Act to speed up family disputes, initiate a review of law relating to habeas corpus and enact relevant changes, introduce policy for Alternative Dispute Mechanism, review Arbitration act, etc.
- empower the vulnerable poor through civil-society led legal literacy, social audit, advocacy, and public interest initiatives (enact and enforce laws for freedom of information, contempt, defamation, consumer protection laws, establish framework to hold civil servants accountable, establish a legal empowerment fund under the AJF to promote legal literacy and advocacy for the poor and disadvantaged, particularly women, commit to publish simplified version of all laws in Urdu, etc.)
- improve judicial governance, introduce professional management, greater transparency and accountability (one or more High Court judges to be responsible for coordinating inspection teams and monitor complaints)
- ensure human resource development for quality judicial service delivery (including increasing the number of women judges).

As indicated above, actions have already been taken in some of these areas. It should be noted that the ADB financial support to that programme (US$330 million) is in the form of a policy-based loan disbursed under four tranches, the last one due to be released in 2004. In addition the ADB has provided a technical assistance loan of US$20 million to facilitate implementation. The programme is evidently wide-reaching and success will lie in a steady and focused implementation. A programme management unit has been established at the Ministry of Law, Justice Human Rights to oversee the implementation.

2.3 The financial system
(Overall rating 3)

2.3.1 The Rules

The Central Bank of Pakistan (State Bank of Pakistan, or SBP) has the full and exclusive authority to regulate and supervise the banking system, operate an independent monetary policy and set limits to government borrowings from the SBP.

The banking and insurance sectors were nationalized during Z. Bhutto's regime in 1974, and during Zia ul Haque's regime the Islamisation of the banking sector was introduced, although it remained quite modest. Liberalisation of the sector started in the late 80s, was pursued in 1990 when two nationalized commercial banks were partially privatised and plans to privatise the others developed. The process of liberalisation, restructuring and privatisation has since then progressed faster, with legal changes in 1996/97 providing autonomy to the SBP and amending the Banking Companies Ordinance of 1962 and the Bank Nationalizing Act of 1974.

The SBP was nationalised in 1974. Previously it was under mixed ownership with the government holding 51% of the shares. Its functions, responsibilities and autonomy increased in 1997 when it was given full and exclusive authority to regulate and supervise the banking system, operate an independent monetary policy, and set limits to government borrowings from the SBP. At the same time, the Pakistan Banking Council was abolished and the authority of the Minister of Finance over the SBP drastically curtailed. The SBP also acquired responsibility to advise the government on all macro-economic matters, which it has used sporadically but effectively. In fact, since 1997, all government borrowings have been made through the auctioning of government securities by the State Bank in the open market.

In December 1999 the Supreme Court decided that the Shariah code (prohibiting interest) should be applied to all financial transactions[124]. Work has been done by the SBP and the government on developing a regulatory and supervisory system adapted to the needs of Islamic Banking (one Islamic Bank has been established). In view of this, and given the government's pragmatic attitude that an Islamic financial system should be introduced gradually and people should have the option to choose the system they prefer, the matter is under review by the supreme court.

In 1997, a Securities and Exchange Commission was established as an autonomous regulatory authority for the securities market and the corporate sector, along the lines of the US Commission.

123 As indicated supra the 1999 governance report of the Mahbub ul Haq Human Development Center quotes a citizen's survey that two-thirds of the population felt that the judges are corrupt, 64% did not believe that the legal framework in the country was just and protective of the people's rights, and nearly all of them considered police officers corrupt.

124 Note that there had been a similar decision in 1992 by the Federal Shariah Court, that was never implemented after the then Government took up the issue with the Supreme Court.

2.3.2 The Structure

The SBP is a well-respected institution whose operations and supervisory functions have been substantially enhanced in the last ten years with assistance from the IMF, the World Bank and the Asian Development Bank. The SBP is managed by a central board of directors (nine members at present) that meets every two months to take administrative and policy decisions, reviews credit and monetary developments, approves the Credit Plan for the year and regularly reports on the state of the economy. SBP's chief executive is the Governor and Chairman of the Board who has full authority to conduct the business of the bank. He is assisted by two Deputy Governors. Board members are nominated and the Governor and Deputy Governors appointed by the federal government. Since 1993, Governors have been former staff of the IMF and the World Bank.

The SBP's operational and organizational structure has been modelled on that of the Bank of England, with two separate departments, one in charge of general banking business and the other of internal management affairs and issuing notes.

The financial sector in Pakistan is highly concentrated in the banking system. In 2000, commercial banks (including coop banks) plus DFIs accounted for more than 90% of the assets of the banking sector, excluding insurance companies (see exhibit 9). At the beginning of 2000 there were 46 commercial banks of which 21 were foreign and 25 domestic (and five NCBs), 14 development finance institutions, 33 leasing companies, six cooperative banks, and 55 modarabas.

In addition there are many informal micro-credit activities in urban areas (usury is supposedly prohibited but still exists, notwithstanding the Islamic prohibition of interest). Also, as indicated above, NGO supporting rural programmes traditionally have had a window for micro-credit, and last year a new bank specialized in micro-credit over the whole country was established (the Kushhali bank).

Stock markets operate in Karachi and, to a very limited extent, in Lahore and Islamabad. Market capitalization had increased to 12% of GDP in 1999, but has since decreased, while the number of companies listed on the Karachi exchange (equities) has also decreased in the last three years to less than 750, reflecting the low business confidence. However there seems to have been a recent reactivation of the stock market.

STRUCTURE OF FINANCIAL ASSETS, 2000

Exhibit: 9

Category	Rs billion	% Of assets	% Of GDP
Banks	1,641	79.5	51.6
Investment Banks	42	2	1.3
DFIs	201	9.7	6.3
Housing Finance	22	1.1	0.7
Leasing	42	2	1.3
Modarabas	17	0.8	0.5
Insurance	98	4.7	3.1
Others	2	0	0
Total	**2,065**	**100**	**64.9**
Equity market			**8.9**

Source: World Bank

NON-PERFORMING LOANS (NPLs) AND DEFAULT LOANS (DLs) FOR BANKS AND DFIs (END 2001 AS % OF ADVANCES)

Exhibit: 10

	NPLs	DLs
NCBs	20.2	15.9
Privatised Banks	18.7	14.8
Specialised Banks	54.5	17.1
Private Banks	18.2	8.5
Foreign Banks	5.6	4.1
DFIs	67.5	36.6
All banks	21	13.4
All banks and DFIs	24.7	15.3

Total Advances /GDP 30% - Total NPLS/GDP 7.4% - Total defaults/GDP 4.6%

Source: World Bank

The Pakistan SEC has been instrumental in developing norms for corporate governance for traded companies, and has provided advice to the government on such matters. There are Chambers of Industry and Commerce in all provinces and a Federation for the whole country, but these are not very active.

2.3.3 Management

With current reforms, efforts are being made to improve the ability of the SBP to regulate and supervise the banking and non-banking systems. Nevertheless, the lack of financial discipline and political interference have considerably affected resource allocation in the past, and pursuing the recent efforts to reform the sector is necessary to improve its overall effectiveness.

A lack of financial discipline and political interference in the system affecting financial intermediation of a banking system dominated by nationalised commercial banks (NCB) were key issues in the financial system. Non-performing loans had reached alarming proportions, and defaults could not be resolved through an ineffective court system.

In early 1997, the Central Bank and the Minister of Finance started implementing a "home-grown" banking reform, with support of the World Bank and the ADB. These reforms aimed to strengthen the sources of governance and financial discipline for the banking sector, by enhancing the authority and ability of the SBP to supervise banks and enforce regulations, promoting market discipline, improving the legal and judicial processes for enforcing contracts (including the creation of special banking courts), and initiating corporate governance reform of NCBs and the Development Finance Institutions (DFI)[125], with a view to privatise them.

The programme started well and by early 1999 the banking sector had improved on most benchmarks. The NCBs, that had been providing professional management, had stemmed operating losses by reducing staff by 30% and closing 500 branches. Cash recovery on loan defaults totalled Rs70 billion during 1997-99, about one third of the stock, and nearly half of the 52,000 loan defaults cases were processed by the new banking court system rapidly (see exhibit 10). There were improvements in capital adequacy, asset quality, and profitability. However, the process slowed down considerably in 1999 and interferences in the banking system started again.

125 These Development Finance Institutions had been set up to promote and support development in various sectors with the provision of LT finance. Apart from the DFI dealing with agriculture, which is still active, most others are now making a very limited contribution to investment – but they still have a large loan portfolio the value of which is often questionable.

The programme put up by the current government[126] and supported by the World Bank (with a US$300 million loan) and the ADB aims to substantially extend the 1997 overall reform programme, and to facilitate bank restructuring and privatisation. Elements of that programme include:

- Complete the privatisation of the two partly-privatised NCBs[127] and privatise the three other NCBs
- Continue the NCB restructuring before privatisation, in particular a 50% staff reduction in order to achieve a cost/income ratio of 0.65 (against 0.7-0.9 at present)
- Reduce the number of DFIs, privatise and/or close them – keeping at most three of the 14, catering for the needs of SMEs, housing finance, and small agriculture
- Liberalise further through particularly the liberalisation of the banks branch policy
- Revise the tax policy and administration to reduce the taxation of the financial sector in line with the rest of the economy
- Improve loan recovery through the establishment of an asset management agency, and facilitate the foreclosure of loan collaterals, through the amendment of the Loan Recovery Act of 1997[128]. An ordinance in 2001 was promulgated to improve the effectiveness of the banking courts that had been established under the 1997 Banking Companies Act
- Reform the National Savings Scheme (NSS) that had caused large-scale financial disintermediation by paying very high tax-free returns, and discontinue the Foreign Currency Deposit (FCD) scheme that had been the cause of a foreign currency crisis in 1998[129].

Overall, these reforms are proceeding as scheduled, and in some areas faster, while further efforts are being made to improve the ability of the SBP to regularise and supervise the banking and non-banking sector.

2.4 Corporate governance *(Overall rating 2)*

2.4.1 The Rules

As regards the public sector, reforms are under implementation to improve the effectiveness of the audit function that has been separated from the accounting function, as indicated earlier.

The legal framework for private sector activities is based on the Companies Ordinance (1984) that has been partially amended in 1996.

2.2.1 The Structure

The National Accountability Bureau (NAB) is the body responsible for public governance in Pakistan having a significant history of heavy corruption. The President established the NAB in 1999 and gave it extensive powers to investigate alleged corrupt behaviour both by "Holders of Public Office" and members of the public. The NAB appears to have had a significant impact on large-scale corruption; about US$1.5 billion has been recovered out of about 1,000 cases investigated, for which nearly 400 cases were filed in courts resulting in 169 convictions. Initially, investigations could entail a three-month detention without trial, but the policy has been moderated as it provoked public concern and some capital flight.

2.2.2 Management

Corruption has been a big impediment for development within the public administration in Pakistan. Nevertheless, some parts of the administration within the government are reportedly more prone to corruption than others, such as the tax administration (the Central Board of Revenues or CBR), the customs department, the police and public utilities (e.g. WAPDA, the electricity distribution company). As discussed earlier, the social sectors have also suffered from a serious lack of accountability and corrupt practices. Some parts of the system, however, have been much less affected – in particular the Central Bank, the part of the Ministry of Finance dealing with external aid and the Central Planning Commission. The current government has put governance reform at the centre of its reform programme. Governance reform is focused on four main issues: devolution, civil service reform, improvement of financial management, and reform of the judiciary.

In order to improve public financial management and accountability, the government has implemented fundamental reforms to strengthen the audit and accounting functions, which have been separated. An Office of the Controller General of Accounts has been established under the Ministry of Finance and has formulated a strategy to improve financial management. Fiscal Monitoring Committees have been established at Federal and Provincial levels to monitor the preparation of reconciled and accurate accounts. Ad-hoc committees have been set up at both federal and provincial levels to clear the backlog of audit reports not yet reviewed, and for the first time in more than a decade, the Federal Public Accounts Committee is reviewing the accounts of a government in office, and the FY2000 Audit Report to the Public Accounts Committee has been released in time. Finally, a strategy for the fundamental reform of the CBR, following extensive consultations, was approved in October 2001 and is being implemented with technical assistance funding from the World Bank, and progress has been made in improving the quality and transparency of the budget at both federal and provincial levels.

As regards private governance, laws and standards are on paper satisfactory, and the establishment of the SEC has permitted progress for the disclosure of information and other governance aspects for listed companies. Still, years of policy uncertainty, accompanied by increasing corruption in the administration and at times substantial law and order problems, have not been conducive to the development of ethical behaviour in the business sector that has tried to survive as best as it could. Fundamentally, as long as governance issues are not addressed effectively, it would be hard to expect that the private sector, whose level of confidence is already very low, would improve its behaviour in the near future. And attracting quality private investment from abroad will also remain extremely difficult.

The table in exhibit 11 indicates that Pakistan may have improved on most indicators of governance since the military takeover of late 1999, except for "voice and accountability", that attempts to measure civil liberties and political rights.

2.3 Trade and Competition *(Overall rating 3)*

2.3.1 The Rules

Pakistan has gone a long way in liberalizing the trade regime and reducing exchange rate distortions, but still more is needed if Pakistan is to compete more effectively in world markets, in particular in the textile and garment sectors which today account for 80% of exports and where the end of the MultiFiber agreement in 2005 will introduce more competition.

A progressive liberalization of the external trade regime resulted in the average tariff now being about 20%. A few industries, however, continue to benefit from high protection, namely steel, polyester and fabrics (up to 35%) and the import tariff for tin plates was recently also raised to 35%. This high protection affects the development or

126 Note that the current Minister of Finance is a former top executive of a large international bank.
127 Already completed for one of them
128 Completed
129 Completed

modernization of the engineering and textile industries.

In addition, while import licensing and quantitative restrictions were abolished long ago, the practice of Statutory Rules and Orders (SRO), which the government had been using to provide partial or full duty exemptions to some industries, has eroded the tariff regime. While the number of SROs has been progressively and drastically reduced over the last five years some subsist noticeably to protect the engineering and chemical industries. On the export side, most export restrictions have been removed. Liberalisation efforts have been constrained since import duties traditionally constituted a major part of government tax revenues and enlarging the tax base and increasing or better managing income or turnover taxes have always encountered substantial resistance.

With regard to internal trade, the Monopolies and Restrictive Trade Practices Ordinance (1970) has been amended to ensure that public enterprises are subject to the same monopolies and antitrust regulations as private enterprises. The Price Control and Prevention of Profiteering and Hoarding Act (1977), which is presently inoperative, is being reviewed to restrict powers to control the pricing of manufactured products.

2.3.2 The Structure

The Customs Department in the Ministry of Finance, the Export Promotion Board (attached to the Ministry of Commerce), and the Board of Investment are the main relevant organizations. The Central Bank also plays a major role through its management of the exchange rate and export financing schemes, and the Privatisation Commission's activities contribute to improved competition when privatising enterprises in those areas where the state is still present.

2.3.3 Management

With main support from the Asian Development Bank, Pakistan has been able to successfully liberalize its trade regime while restructuring and increasing efficiency in the key bodies responsible for trade management.

Under a Trade, Export Promotion and Industry Programme, launched in 1996 and supported by the Asian Development Bank with an adjustment operation and technical assistance grants in 1999, major efforts have been launched to further liberalize the trade regime, improve the effectiveness of relevant organizations, and assist Pakistan to put in place the institutional capacity to implement the Uruguay round. Liberalization of the trade regime has gone forward as indicated above and the current government has plans to progressively eliminate most of the remaining issues. Financing for exporters has been broadened and access has improved.

The most recent development in that area is the establishment in 2001 of a trade finance facility for SMEs, supported by a US$150 million partial risk guarantee from the Asian Development Bank. The Export Promotion Board is progressively being restructured to move it away from managing the textile quota policy and orient it toward overseeing the modernization of the export policy framework to encourage higher value and improved competitiveness of exports. Finally the Board of Investment is also being strengthened and is now supported by a private advisory council.

Progress has also been made in developing institutional capacities. In 1998, a National Accreditation Council was established. It will accredit National Physical Standards Laboratories and other laboratories to calibrate their testing equipment. The Pakistani Standards and Quality Control Authority is being strengthened to certify bodies to issue ISO 9000 certificates (dealing with environment). As to the Customs Department, plans to make it more effective are being developed as part of the civil service reform mentioned earlier.

GOVERNANCE INDICATORS FOR PAKISTAN, 1997/98 AND 2000/01

Exhibit: 11

Governance Indicator	Year	Percentile Rank* (0-100)	Estimate (-2.5 to + 2.5)	Standard Deviation	Number of surveys/ polls
Voice and Accountability	2000/01	5.2	-1.43	0.24	5
	1997/98	36.8	-0.44	0.25	3
Political Stability/No Violence	2000/01	35.2	-0.39	0.26	6
	1997/98	25.0	-0.65	0.26	5
Government Effectiveness	2000/01	36.3	-0.48	0.22	6
	1997/98	19.1	-0.74	0.26	5
Regulatory Quality	2000/01	30.8	-0.38	0.34	5
	1997/98	32.9	-0.20	0.27	4
Rule of Law	2000/01	25.3	-0.74	0.22	7
	1997/98	24.0	-0.76	0.24	6
Control of Corruption	2000/01	24.8	-0.79	0.24	6
	1997/98	23.7	-0.77	0.22	6

Source: Kaufmann, Kraay and Zoido (KKZ), 2002: Governance Matters II: Updated Governance Indicators for 2000-01

*Indicates the percentage of countries worldwide that rate below the selected country, subject to a margin of error.

3. CONCLUSIONS

For most of its existence, Pakistan has been able to grow at an impressive rate despite three wars and major internal changes, investing a substantial part of its resources in an area – defence expenditures – that is not known for its impact on development. This, combined with the increased cost of the inability to improve the fiscal balance, has progressively resulted in Pakistan getting into a debt trap and huge aid dependency. Per capita income has increased, but there has been little movement to reduce poverty in the last ten years. Income distribution has worsened, and there has been little progress on the social front, particularly in education.

Pakistanis are well aware of what is needed to put the country on a sustained path of growth and development. Efforts to achieve this in the past have failed, mostly because of increasingly bitter disputes between political parties representing divergent interests, that have tended to favour their own main supporters and a small elite rather than trying to help the population at large. As a result, the army has stepped in twice in the past, and is now stepping in again, after Pakistan's situation was one of near collapse.

Another major effort, and one that is more comprehensive than in the past, is being put by the current military government, to try to set Pakistan on a steady and effective growth and development path. The current reform attempts to go to the heart of problems that have undermined the country's social fabric and brought public confidence down to miserably low ebb. Governance issues are at the forefront of the current government programme, which includes major reforms of the political, judicial, financial and administrative infrastructure. Implementation of this reform package seems to have started well, but its success needs steady efforts over a long time.

Will that reform programme succeed? Pakistanis seem to be much divided on this. After all, it is not the first time that a government tries to correct some of the basic deficiencies in the institutional and policy framework. Developing a new tier of government has been tried (although much less comprehensively) before, and there have already been some (short term) drives for accountability. Also, is imposing a referendum and a constitutional change, consistent with a programme with a major focus on governance and transparency? Conversely, would reforms of that amplitude and depth have better chances to succeed if implemented by a military government, as implementation may not be affected by the resistance of the vested interests of some existing elites? Will the growing participation of the armed forces in the management of the economy affect the longer term need to develop democratic institutions? Interestingly, growth rates during military regimes in the past have been higher than during civil regimes.

Have politicians learnt their lessons? This is not easy to respond. Would a civil government coming out of the elections of October 2002 have managed the implementation of a package of reforms that everybody recognizes as necessary, as well, or better, than a President obtaining a five-year term from a referendum working with a docile, or resigned, parliament?

These are hard questions that only Pakistani people can answer.

Finally, Pakistan has little choice but to continue depending upon steady support from donors to be able to implement its programme. There are three aspects that come to mind in this respect. First, stability in the region is crucial for Pakistan's (and other countries') ability to grow on a steady footing. Can donors, or rather the governments they represent, help, or be more forceful, in ensuring this long-term political stability? Second, reforms of the type that Pakistan is attempting take a long time to implement – much longer than a typical IMF programme or an adjustment operation. How to devise a consensus between donors and Pakistan that such long-term support will be available is probably needed – and this supposes that the Pakistanis can commit together to such a long-term vision? Third, irrespective of the response to the first two questions, Pakistan must improve its ability to manage its own future, and its credibility vis-à-vis its external partners.

Pakistan has a long way to go, as reflected in the scoring of its institutional infrastructure shown in the next two pages[130].

130 Scoring is difficult to do in the midst of the implementation of a reform, and therefore reflects the "best judgment" at this time. To a large extent, it reflects the situation that this government inherited, rather than progress made in some areas, mostly because only time will permit to know whether implementation leads to sustainable improvements. If one were to score the content of the reform, scores would be much higher in many areas.

4. INSTITUTIONAL INFRASTRUCTURE MANAGEMENT

OVERALL SCORECARD

		Quality[131]					
		1	2	3	4	5	6
Political System	Rules			X			
	Structure			X			
	Management[132]		X				
	Combined Rating			**X**			
Legal Framework	Rules			X			
	Structure		X				
	Management		X				
	Combined Rating		**X**				
Financial System	Rules				X		
	Structure			X			
	Management			X			
	Combined Rating			**X**			
Corporate Governance	Rules			X			
	Structure		X				
	Management		X				
	Combined Rating		**X**				
Trade & Competition	Rules				X		
	Structure			X			
	Management			X			
	Combined Rating			**X**			
Overall Rating				**X** **2.8**			

131 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good

132 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption	X					
	Combined Score		**X**				
Legal Framework	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making	X					
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption	X					
	Combined Score		**X**				
Financial System	Objective Setting & Accountability				X		
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures			X			
	Costs / Waste		X				
	Corruption			X			
	Combined Score			**X**			
Corporate Governance	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Trade & Competition	Objective Setting & Accountability				X		
	Effective Decision Making			X			
	Efficiency of Procedures			X			
	Costs / Waste			X			
	Corruption		X				
	Combined Score			**X**			

A SHORT REVIEW OF POLITICAL AND ECONOMIC DEVELOPMENTS SINCE INDEPENDENCE

The early years of the Federation (1947-1957)

This first period was concentrated on attempting to build a viable political and administrative system, and economic management was restricted to managing ad-hoc crises by the various governments that were in power during that period. Overall average growth was 3.2% during the period, but manufacturing grew at a fast rate of 9.6% - albeit from a very slow base, under the start of an import substituting policy. Inflows of foreign capital were only about 1% per year. The first war with India took place shortly after Pakistan was created.

The first military rule – the Ayub Khan years (1958-1970) [133]

The military regime of general Ayub Khan in 1958-69 continued this policy of industrial development. The large-scale manufacturing sector grew at more than 9% during the period, although this was done under substantial protection. Pakistan was in the mid 60s a dominant exporter of manufactured goods in Asia. At the same time Pakistan's administrative capacity was strengthened through a major expansion of the policy analysis, design and implementation, including the creation of the Planning Commission that still exists today. Finally, there was a reversal of the neglect in agriculture, and the introduction of high yield varieties and modern technology led to a "green revolution". Despite the war with India in 1965, GNP growth rates were on average about 6% for the period. Pakistan started also to rely extensively on foreign aid, which reached more than 6% of GDP in 1965 – before being curtailed after the war with India.

The second attempt at democracy – Z. Bhutto and a socialist experiment (1971-1977)

Following the secession of East Pakistan and the defeat in the war with India, Pakistan embarked with Z. Bhutto as Prime Minister in a broad restructuring of the economy under an ambitious set of populist and socialist oriented reforms, partly in reaction to the wealth amassed during the industrial boom by private industrialists. All banks and insurance companies were nationalized in 1974, together with a substantial part of the industrial sector. Public investment rose rapidly and substituted for private investment that decreased strongly. A land reform also took place in 1972, although its effect remained limited, and the agriculture sector stagnated due to a combination of exogenous and policy factors, including low output prices. Balance of payments difficulties in part due to the oil shocks led to substantial borrowings abroad (both public and private) and a growing dependence on foreign savings (including remittances that grew rapidly in the 70s). On the political side, Z. Bhutto tried to reduce the power of the army and the bureaucracy, and economic policy-making became more politicised and personalized. The hopes of more social justice that had brought Z. Bhutto to power were not fulfilled, as all indicators showed an increase in income inequality between 1972 and 1980. Growth was about 5% during the Bhutto period - performance was much higher in the early years, due to a recovery after the war, than in the later years. Most growth took place in the construction and trade sector – manufacturing and agriculture were sluggish at 2.5 -3.5 % on average. A new constitution, still in use today, was approved in 1973.

The second military rule – the Zia ul Haq years (1977-1988)

The military rule of General Zia ul Haq showed a return to centralized political power, and an attempt to Islamise the society, which introduced divisive factors into the country's society and polity. An amendment to the Constitution was passed to give broad powers to the President (power to dismiss the government and to appoint army chiefs and provincial governors). All political party activity was prohibited but limited participation in government at the local level was allowed, in an attempt to create representative decentralized institutions. The 80s saw a reversal of the public-led sector growth strategy, and growth was a respectable 6% during the decade, but fiscal sector deficits increased and averaged 8% of GDP in the late 80s. They were caused mostly by increases in current and defence expenditures, and led to increased borrowing domestically, which would have serious repercussions for public finances and macro-economic stability in the 90s. Remittances from workers in the Middle East continued to be very high – about $3 billion on average per year i.e. about 10% of GDP, and supplemented household incomes while financing much of the trade deficit. However the impact of these flows was weakened by some capital flight from Pakistan. According to some estimates, deposits by Pakistani abroad increased by over $1 billion during the period. Finally, the Russian invasion of Afghanistan, and the consequent support by Pakistan for US policy, led to increased aid flows while providing political legitimacy to a regime that was facing credibility problems.

Third attempt at democracy - the turbulent 90s with Nawaz Sharif and Benazir Bhutto

With the return to elected governments in 1988, the end of the cold war and the withdrawal of Russia from Afghanistan, the geopolitical scene in and around Pakistan changed. The transition to civilian rule after years of military regime was not easy, however[134]. The two dominant parties (Muslim League and People's Party of Pakistan –PPP)[135] and their leaders (Nawaz Sharif and Benazir Bhutto) jockeyed incessantly for power. While they shared a fundamental consensus on economic policies, the bitter quarrels between the parties and their leaders, not because of ideological reasons, but motivated essentially by power, ambition and cronyism, led to weakening of institutions and corruption, and disruptions in economic management. This resulted in lower business confidence and smaller private investment. Total investment fell from about 18% of GDP in the early 90s to 13% in 2000. A number of reform programmes were started, focusing mostly on the trade and financial sectors, and on industry, and a first wave of privatisation took place. However, the reforms could not be sustained. The decade saw a continuation of the fiscal deficit around 6%, and an increased dependence on aid as remittances flows decreased, and private flows after a spur in the early 90s reduced to very little later. None of the nine IMF-supported

133 General Yahia Khan ruled in 1969-70.
134 Note that during the second N. Sharif government the constitutional amendment providing large powers to the President was abrogated.
135 The PPP is dominated by landlords and has a strong base in rural areas. The Muslim League is more linked with urban classes and industrialists.

reform and adjustment programmes initiated during that period was completed, and the credibility of Pakistan vis-à-vis the donors progressively eroded. There was an attempt, supported successively by both parties, and assisted by all donors, to improve the social conditions in the country. However the major programme launched for that objective - the SAP, was a failure mostly because of poor governance and because the complexity of its design was totally out of sync with institutional capacities.

Similarly, Pakistan was the first country to mobilize substantial private capital for power generation, but the implementation of that programme was marred by accusation of corrupt practices and led to over capacity in the sector. In the late 90s, the GDP growth rate fell below 4%. On the external side, the US suspended its aid to Pakistan in 1990 because of the nuclear development after the Russia had left Afghanistan. Following the explosion of a nuclear device in 1998 (in response to India's exploding its device), all industrial countries suspended aid and put in place sanctions that reduced new commitments by multilaterals to very little. Over the decade, regular tension on the border with India led to continuous high defence spending and containment of development expenditures.

Finally, the deterioration of the situation in Afghanistan during the decade had a severe impact on Pakistan, partly because of the problems associated with heroin production and marketing, partly because of the effects of instability in that country. Confidence of the people in Pakistan in their political, financial, legal institutions progressively eroded and was extremely low at the end of the century. According to the 1999 study on Governance by the Mahbub ul Haq Human Development Centre in Pakistan, 64% of Pakistanis did not believe that the legal framework in the country was just and protective of people's rights, 67% felt that the judges were corrupt, and nearly all of them considered police officers corrupt.

Near collapse at the end of the millennium, and the start of a third military rule

At the time General Musharraf took over and established again a military regime that was "legitimised" by a decision of the Supreme Court of Pakistan in late 1999, the country was on the verge of collapse. Political parties and their leaders were discredited, permanent fiscal deficits had resulted in an unsustainable level of debt, poverty was not being reduced, the economy, that had outlived years of changes and reversal and continued to grow at rates well above the population growth rate, was now in serious trouble, private investor confidence was very low, and one wondered how Pakistan had been able to withstand an economic crisis of the Russian or Argentina type[136]. Finally, years of neglect of the social sectors had led to a situation where Pakistan lags behind countries with comparable per capita income on most of the social indicators. The civil service was in need of reform because of overextension and corruption. While there remained a small cadre of highly talented and dedicated professionals particularly at the top level[137], the rest of the service suffered from seriously eroded internal accountability and lack of accountability with the public. The quality of public services had considerably deteriorated.

The current reform programme – a comprehensive approach to long term issues

The military government that took office in October 1999 rapidly launched a comprehensive reform programme that attempts to address the issues evoked in the first part of this report, namely governance, slow growth, social gap and the heavy debt burden. While some of these reforms have been attempted before, they were partial, and issues of corruption, weak institutions and governance were not put at the forefront of the reform as they appear to be now. This programme is supported by the IMF, that initially approved a Standby Credit (one year) of US$600 million (November 2000), and later, upon successful execution of the programme, approved in December 2001 a three-year Poverty Reduction and Growth Facility (PRGF) amounting to about US$1.3 billion. The first review under this PRGF, done in March 2002, concluded that the overall programme was on track – although growth prospects had to be scaled down and tax revenue was lower than expected. Other donors have supported the programme with substantial assistance[138] and in December 2001 the Paris Club agreed to a major debt restructuring workout considering the whole debt stock, that will provide gross cash flow relief of about US$3.6 billion during the programme period (up to mid 2004). This provides some much breathing space for Pakistan and should be of great help for the sustained implementation of the programme.

The core of the government reform agenda, described in detail in Pakistan's Interim Poverty Reduction Strategy Paper, focuses on six areas: governance, investing in people, macroeconomic sustainability, the financial sector, the investment climate for the private sector, and agriculture and irrigation. The main macro-economic parameters under the programme are as shown in the table below.

	1999/00	2000/01	2001/02	2002/03	2003/04
GDP Growth (%)	3.9	2.7	3..3	4.7	5.2
Gross National Savings/GDP (%)	13.7	13.1	15.4	15.4	15.8
Gross Capital Formation/GDP (%)	15.6	14.7	15.2	16.6	17.5
Budget deficit (excl grants)/GDP (%)	-6.5	-5.3	-5.7	-4.2	-3.3
External public debt/GDP (%)	48.3	52.7	52.0	50.4	48.1
Ext. Pub Debt service/exports (%)	40.4	32.9	35.8	31.8	28.2

Source: IMF

Inflation is assumed at around 3%. Gross financing requirements for 2001/02 to 2003/04, as per the recent review, are about US$20 billion, of which about US$14 billion of debt amortization. Debt relief from the Paris Club will provide US$3.5 billion, balance of payment support from the ADB and the World Bank and disbursements on previously committed aid a total of US$6.3 billion, debt financing from private creditors US$7.3 billion, and Foreign Direct Investment US$2 billion. The IMF would contribute US$1.3 billion.

Details of the various elements of the reform programme are included in the chapters in this report dealing with each relevant aspect of the programme.

136 In 1993 also, the level of reserves of Pakistan was extremely low and Pakistan could only survive because it put in place quickly, under M Qureshi's interim government, a reform and adjustment programme that was supported by the IMF and the IFIs. B Bhutto, who took over after the elections in late October, started indeed continuing implementing this program, which fizzled out progressively before she was removed from office in 1996.

137 The DMG group (District Management Group). An elite group of civil servants often educated in Oxford or Cambridge that join the civil service under competition, and progressively go through various sectors/locations/levels of responsibility to usually end as secretary in a federal or provincial ministry. The civil service of Pakistan (CSP) was formed along the lines of the civil service that the British had developed in India long ago, and that still subsides in its essential features in India.

138 Adjustment operations by the World Bank/IDA (US$300 million for banking sector restructuring) and by the Asian Development Bank (US$330 million for reform of the judicial system).

SUMMARIZED HISTORY OF PAKISTAN

1947	Creation of Pakistan (including East Pakistan)
1947-48	First war with India over Kashmir. Pakistan loses
1947-57	Succession of various democratic governments
1958	General Ayub Khan takes over and sets up the first military government
1965	Second war with India over Kashmir. Pakistan loses
1969	General Yahia Khan succeeds general Ayub Khan
1970	Elections. In East Pakistan Mujibur Rahman gets 167 out of 169 seats and in West Pakistan Sulfikar A. Bhutto's party (Pakistan People Party) gets 88 seats of 144 seats. A constitutional dispute ensues and leads to insurrection in East Pakistan while Bhutto is PM in West Pakistan
1971	War with India. Pakistan loses. East Pakistan secedes and becomes Bangladesh
1973	New constitution
1977	Elections. Bhutto wins, but is ousted and general Zia al Haq takes over
1979	Bhutto is hanged following decision of Supreme Court that he is guilty of involvement in murder of political opponent
1981	Following the Soviet invasion of Afghanistan, the US provides a US$3.2 billion package of economic and military aid to Pakistan for 5 years
1985	Referendum on Islamisation and elections. Junejo becomes PM
1986	Second US aid package of US$4 billion for 4 years, which is suspended in 1990 following Soviet withdrawal form Afghanistan and lack of certification by US president that Pakistan does not possess nuclear device
1988	Zia ul Haque dies in plane crash. New elections bring Benazir Bhutto as PM
1990	President Ishaq Khan dismisses B. Bhutto. Elections bring to power Nawaz Sharif (Muslim League)
1993	Following removal of N. Sharif and President, M Qureshi becomes PM ad interim and organizes elections. B. Bhutto's PPP wins and she becomes PM. F.Leghari becomes President
1996	F Leghari dismisses B. Bhutto's government
1997	Muslim League wins overwhelmingly elections and N. Sharif becomes PM. Constitution is amended
1998	India and Pakistan have nuclear tests. Sanctions follow
1999	General Musharraf deposes N Sharif in a coup. New sanctions. After September 11 (2001), Musharraf offers cooperation with US on fight against terrorism. Most sanctions are withdrawn and US promises substantial economic aid package
2000	Supreme Court legalized Musharraf's coup; parliamentary elections are to be held before end of 2002
2002	April. Musharraf announces a referendum that would permit him to stay 5 years as President. Constitution would be changed to develop new relations between the President and the PM following elections in October

POWER GENERATION

HUB and IPP in Pakistan

Faced with power shortages, Pakistan decided in the late 80s to encourage private participation in power generation. The first project was the Hub project, a 1,300MW power plant close to Karachi, at a cost of US$1.8 billion. As it was the first large private project in power in developing countries, it took eight years to complete the financing – a number of events, among which the Gulf war and a Shariah court decision in Pakistan on payment on interest – lengthened the process by three to four years.

The development of Hub has led to the transformation of the private infrastructure market, from being a rare curiosity outside industrial countries, to mainstream policy for many countries both industrial and emerging. It was also for the World Bank the first time it used a new facility – partial risk guarantee – to facilitate private investment in developing countries.

Thus, in terms of innovation, this project was a critical landmark – but it suffered in terms of cost and processing time from being a testing ground for many other similar projects later.

Following the development of the Hub project, the government of Pakistan (GOP) launched a streamlined policy to build on the success of the Hub project and bring in additional private participation in power generation (independent power producers, or IPP). This was more successful than intended – 33 such projects for about 7,500MW were approved, but half of that additional capacity was probably necessary at that time.

Development of the Hub project took place during both N. Sharif and B. Bhutto's governments, but the IPP policy was mostly developed and implemented during B. Bhutto's 2nd government. After coming back into office, N. Sharif charged that IPP had engaged in price fixing and had paid bribes to officials of the previous government. This led to a bitter and acrimonious dispute, which mostly focused on a reduction of the price of 6.6 cents per kwh that most IPPs had in their initial contracts. The dispute was settled in late 2000 under the new military regime, but it had taken a heavy toll on business confidence.

The World Bank, the IFC and other multilateral and bilateral agencies contributed substantially to the financing of Hub and other IPP, and got embroiled in the dispute and the accusations.

THE SOCIAL ACTION PROGRAMME (SAP)

The Social Action Programme (SAP), launched in 1993, was an attempt to: (a) improve the delivery systems in the social sectors resulting in increased coverage and quality of services in basic education, primary health, rural water supply and sanitation, and population welfare; (b) increase budgetary resources allocated to these sectors, and (c) be used as a vehicle for policy dialogue between the donors and the government of Pakistan (GOP). Over the ten years 1993-2003, about US$14 billion were to be invested in those sectors with donors contributing roughly 25% of the total.

Implementation of this ambitious programme was to be done under complex arrangements and agreements between donors and GOP, calling for yearly operational plans (OP) for each sector and GOP implementing agency (i.e. 27 sub programmes). Specific monitoring and evaluation arrangements were to be put into place, with quarterly reviews of the implementation of the OP. Substantial technical assistance funding was made available to support capacity and institution building in the sectors. The mechanism for donor disbursements was innovative: they would disburse their contribution as a percentage of GOP's disbursements from agreed budget allocations.

Expenditures under the SAP increased initially but decreased after 1997, although they were more protected than others in the budgets, and stayed at around 2% of GDP during the period.

The results in terms of output were much disappointing. While there was some progress in health and population indicators, the improvements in education, where 60% of expenditures occurred, did not take place and in some indicators the situation worsened. Although a component of the SAP was designed for use by local communities and NGOs very little use was made of that facility. Finally the policy dialogue between GOP and donors did not improve much although the mid-term review of the SAP in 2000 led to the beginning of a joint effort in that area. One interesting aspect of SAP monitoring was the checks done by the Auditor General on selection of sites for schools and health units, and absenteeism of doctors and teachers, etc. which started documenting the very poor governance at the local level, and the lack of controls at the provincial level.

The programme was thus abandoned prematurely in 2001 and donor funding partly reallocated to a GOP-created Poverty Alleviation Fund using NGOs for its assistance.

While the SAP did result in focusing more the attentions on the very poor state of the social sectors in Pakistan, its failure – mostly due to too complex arrangements being put on a weak governance and administrative system – demonstrated further that these issues of governance, institutional capacity at all levels, and solid monitoring and evaluation systems are at the core of problems that Pakistan faces today.

PAKISTAN'S LEGAL AND POLITICAL SYSTEM

Government type: Federal republic

Capital: Islamabad

Administrative divisions: 4 provinces, 1 territory*, and 1 capital territory**; Balochistan, Federally Administered Tribal Areas*, Islamabad Capital Territory**, North-West Frontier Province, Punjab, Sindh

note: the Pakistani-administered portion of the disputed Jammu and Kashmir region includes Azad Kashmir and the Northern Areas

Independence: 14 August 1947 (from UK)

National holiday: Republic Day, 23 March (1956)

Constitution: 10 April 1973, suspended 5 July 1977, restored with amendments 30 December 1985; suspended 15 October 1999

Legal system: based on English common law with provisions to accommodate Pakistan's status as an Islamic state; accepts compulsory ICJ jurisdiction, with reservations

Suffrage: 21 years of age; universal; separate electorates and reserved parliamentary seats for non-Muslims

Executive branch: Note: following a military takeover on 12 October 1999, Chief of Army Staff and Chairman of the Joint Chiefs of Staff Committee, Gen. Pervez MUSHARRAF suspended Pakistan's constitution and assumed the additional title of Chief Executive; exercising the powers of the head of the government, he appointed an eight-member National Security Council to function as Pakistan's supreme governing body; President Mohammad Rafiq TARAR remained the ceremonial chief of state until General MUSHARRAF assumed the Presidential post himself; on 12 May 2000, Pakistan's Supreme Court unanimously validated the October 1999 coup and granted MUSHARRAF executive and legislative authority for three years from the coup date

chief of state: President Mohammad Rafiq TARAR (since 31 December 1997);
General MUSHARRAF (since June 2002)

head of government: Chief Executive Gen. Pervez MUSHARRAF (since 12 October 1999)

cabinet: Cabinet appointed by the chief executive

elections: president elected by Parliament for a five-year term; election last held 31 December 1997 (next to be held October 2002); following legislative elections, the leader of the majority party or leader of a majority coalition is usually elected prime minister by the National Assembly; election last held 3 February 1997 ; note - Gen. Pervez MUSHARRAF overthrew the government of Prime Minister Mohammad Nawaz SHARIF in the military takeover of 12 October 1999; in May 2000, the Supreme Court validated the October 1999 coup and set a three-year limit in office for Chief Executive MUSHARRAF

election results: Rafiq TARAR elected president; results are for the last election for prime minister prior to the military takeover of 12 October 1999 - Mohammad Nawaz SHARIF elected prime minister;

Legislative branch: Note: Gen. Pervez MUSHARRAF dissolved Parliament following the military takeover of 12 October 1999; bicameral Parliament or Majlis-e-Shoora consists of the Senate (87 seats; members indirectly elected by provincial assemblies to serve six-year terms; one-third of the members up for election every two years) and the National Assembly (217 seats - 10 represent non-Muslims; members elected by popular vote to serve five-year terms)

elections: Senate - last held 12 March 1997 ; National Assembly - last held 3 February 1997; next elections in October 2002

election results(1997): Senate - percent of vote by party - NA%; seats by party - PML/N 30, PPP 17, ANP 7, MQM/A 6, JWP 5, BNP 4, JUI/F 2, PML/J 2, BNM/M 1, PKMAP 1, TJP 1, independents 6, vacant 5; National Assembly - percent of vote by party - NA%; seats by party - PML/N 137, PPP 18, MQM/A 12, ANP 10, BNP 3, JWP 2, JUI/F 2, PPP/SB 1, NPP 1, independents 21, minorities 10; note - Gen. Pervez MUSHARRAF dismissed Parliament 15 October 1999

Judicial branch: Supreme Court (justices appointed by the president); Federal Islamic or Shariah Court

Political parties and leaders: Note: Gen. Pervez MUSHARRAF dissolved Parliament following the military takeover of 12 October 1999, however, political parties have been allowed to operate; Awami National Party or ANP [Wali KHAN]; Balochistan National Movement/Hayee Group or BNM/H [Dr. HAYEE Baluch]; Baluch National Party or BNP [Sardar Akhtar MENGAL]; Jamhoori Watan Party or JWP [Akbar Khan BUGTI]; Jamiat-al-Hadith or JAH [Sajid MIR]; Jamiat Ulema-i-Islam, Fazlur Rehman faction or JUI/F [Fazlur REHMAN]; Jamiat Ulema-i-Pakistan, Niazi faction or JUP/NI [Abdul Sattar Khan NIAZI]; Millat Party [Farooq LEGHARI]; Milli Yakjheti Council or MYC is an umbrella organization which includes Jamaat-i-Islami or JI [Qazi Hussain AHMED], Jamiat Ulema-i-Islam, Sami-ul-Haq faction or JUI/S [Sami ul-HAQ], Tehrik-I-Jafria Pakistan or TJP [Allama Sajid NAQVI], and Jamiat Ulema-i-Pakistan, Noorani faction or JUP/NO [Shah Ahmad NOORANI]; Mutahida Qaumi Movement, Altaf faction or MQM/A [Altaf HUSSAIN]; National People's Party or NPP [Ghulam Mustapha JATOI]; Pakhtun Khwa Milli Awami Party or PKMAP [Mahmood Khan ACHAKZAI]; Pakhtun Quami Party or PQP [Mohammed AFZAL Khan]; Pakistan Awami Tehrik or PAT [Tahir ul QADRI]; Pakistan Muslim League, Functional Group or PML/F [Pir PAGARO]; Pakistan Muslim League, Junejo faction or PML/J [Hamid Nasir CHATTHA]; Pakistan Muslim League, Nawaz Sharif faction or PML/N [Nawaz SHARIF]; Pakistan National Party or PNP [Hasil BIZENJO]; Pakistan People's Party or PPP [Benazir BHUTTO]; Pakistan People's Party/Shaheed Bhutto or PPP/SB [Ghinva BHUTTO]; Pakistan Tehrik-e-Insaaf or PTI [Imran KHAN]

Note: political alliances in Pakistan can shift frequently

COUNTRY REPORT - PERU

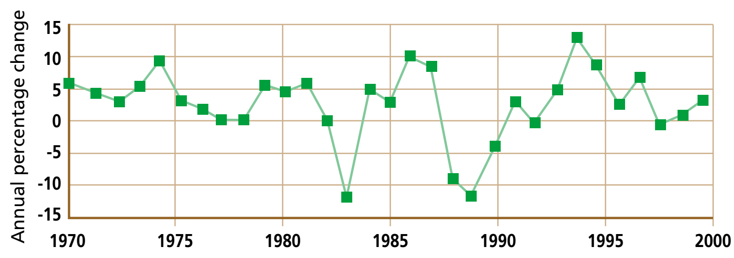
SIGNIFICANT AID AND PRIVATE INVESTMENT FAILING TO IMPROVE THE LIVES OF ITS CITIZENS

1. DEVELOPMENT PERFORMANCE

Since the 70s Peru has had a volatile economic performance, although it has become a more stable country in the past decade following the 80s economic mismanagement, hyperinflation and rampant terrorism. Peru's adjusted real per capita GDP is US$4,680, and it ranks 80 out of 174 in the UNDP Human Development Index (year 1999), making it a 'medium human development' country. The Atlas method GNI per capita (year 2000) is US$2,080 compared to an average of US$3,680 for Latin America and the Caribbean as a whole. Peru is ranked as a lower middle-income country according to the World Bank.

REAL GDP GROWTH IN PERU

Exhibit: 1



Source: Compiled from World Economic Outlook database: IMF

CENTRAL GOVERNMENT FISCAL BALANCE (AS A PERCENTAGE OF GDP)

Exhibit: 2

	1972	1978	1982	1988	1995	1996	1997	1998	1999	2000
Government deficit (-)/surplus	-3.7	-4.9	-3.9	-2.9	-1.1	2.8	0.6	-0.1	-2.2	-2.0

Source: Compiled from International Financial Statistics: IMF

1.1 Economic performance

Peru was under military rule from 1968 to 1975, an era marked by land reform, increased national control of natural resources and industries, spiralling debt and spending increases. The regime ended with a bloodless coup in 1975 and General Morales Bermúdez became president. During this period Peru's GDP growth remained volatile.

During the 80s the Peruvian government pursued economic policies which produced a see-saw effect on economic growth. The first half of the 80s saw Mr. Belaunde as president, his second term in office. A debt crisis and political violence thwarted his attempts at reform and liberalization. In this period, real GDP advanced by just over 1% per annum and plummeted by 11.8% in 1983 (see exhibit 1). The second half of the 80s saw Mr. Alan Garcia Perez as president. His initial economic policies generated high GDP growth rates but soon gave way to hyperinflation[1] and increased poverty. Real GDP fell by 11.6% in 1989.

By 1990, the economy was on the verge of collapse. Mr. Fujimori, a political unknown with no party or programme except his promise of 'hard work, technology and honesty', came to power after the 1990 election. He quickly set about implementing a stabilization programme, the outcome of which was a deep recession, although hyperinflation was brought under control. He adopted a zero tolerance policy on terrorism and following the capture of the leader of the guerrilla group Sendero Luminoso, Abimael Guzman[2], it began to disintegrate. Macroeconomic reforms in the 90s produced strong growth – real GDP advanced by over 4% on average per annum during 1990 to 1997. The strong growth in 1994 to 1995 reflected strong investment fuelled by large capital inflows[3].

During this period a determined effort was made by the authorities to bring the Fiscal situation under control. After averaging 4.5% of GDP in the latter half of the 80s, the government managed to record a central government surplus of 2.8% of GDP in 1996, decelerating to 0.6% of GDP by 1997. Over this period, state subsidies were abolished, expenditures were kept under control as the role of the state was scaled back, and an ambitious privatisation programme was undertaken. And, on the revenue side, a fundamental reorganization of the tax authority helped improve tax collection rates significantly.

The drying-up of foreign capital in the wake of the Asian financial crisis hit the Peruvian economy hard in 1998 and growth in 1999 came from the primary sectors of the economy only. Real GDP increased by less than 1% in 1999 and central government deficits re-emerged. The domestic economy continued to endure the effects of the El Niño weather phenomenon that hit agricultural harvests in late 1997 and early 1998. Domestic demand remained depressed in 2000 with the increase in public expenditure in the run-up to the elections in April and May offset by low levels of investment caused by the political uncertainty (EIU, 2002). Real GDP accelerated by 3.1% in 2000.

The Peruvian authorities are now committed to improving the fiscal situation and have passed a law that dictates a combined public sector deficit of 2.0% of GDP in 2000[4] (see exhibit 2). Moreover, the establishment of the Ministry of Economy and Finance web-site that includes information on the execution of the budget, fiscal projections and the government's policy strategy is a step towards improving the transparency of government operations.

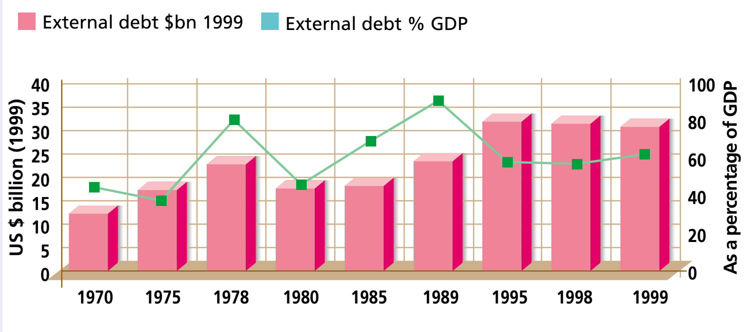
External debt

External debt – the sum of public, publicly guaranteed, private non-guaranteed long term debt, IMF credit and short term debt – has, as can be seen in the following exhibit 3, increased in

1 By 1990 inflation exceeded 7,500%.
2 Sendero Luminoso flourished during the 80s and had contributed to the demise of over 25,000 lives and cost an estimated US$22bn in damage to infrastructure. Following the capture of the leader it began to disintegrate.
3 A surge in private and public investment raised the investment/GDP ratio from 16.7% in 1990 to 21.2% in 1994 (EIU, 2002).
4 The Fiscal Prudence and Transparency Law (December, 1999) that sets limits on public expenditure and the overall and primary balances of the non-financial public sector (NFPS). (EIU, 2002).

EXTERNAL DEBT IN PERU

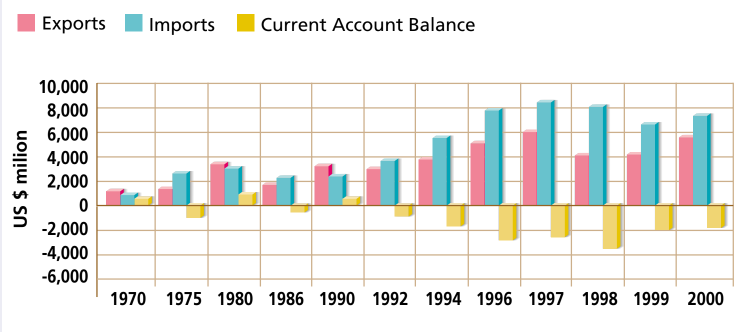
Exhibit: 3



Source: World Bank and IMF

TRADE IN PERU

Exhibit: 4



Source: Economic Commission for Latin America and the Caribbean (CEPAL)

COMPOSITION OF TRADE IN PERU

Exhibit: 5

	Exports			Imports		
	1990	1998	2000	1990	1998	2000
Non-industrialised goods	**28.8%**	**31.1%**	**25.8%**	**15.4%**	**13.2%**	**15.7%**
Agriculture	7.5%	13.1%	9.9%	9.1%	7.3%	5.9%
Mining	20.7%	15.4%	13.7%	0.3%	0.3%	0.2%
Energy	0.6%	2.7%	2.2%	6.1%	5.7%	9.6%
Industrialised goods	**71.2%**	**68.8%**	**74.2%**	**84.5%**	**86.8%**	**84.3%**
Consumer goods (traditional)	15.5%	13.7%	21.3%	13.9%	8.8%	5.9%
Other traditional goods	14.7%	17.1%	16.1%	6.2%	11.7%	12.4%
High economies of scale products	39.8%	34.0%	34.8%	28.3%	23.2%	27.6%
Lasting goods	0.2%	0.5%	0.3%	7.1%	12.2%	9.6%
High value added products	0.9%	3.5%	1.8%	29.1%	30.9%	28.8%
Other goods	0.0%	0.1%	0.0%	0.0%	0.0%	0.0%
TOTAL	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Economic Commission for Latin America and the Caribbean (CEPAL)

real terms from US$13.8 billion in 1970 to US$32.3 billion in 1999, almost a three-fold increase. Over the period, external debt reached a high of US$33.7 billion in 1997, although, as a proportion of GDP external debt fell from a high of over 90% in 1989 to 62.2% in 1999.

Peru declared a moratorium on the servicing of its external debt between 1985 and 1990 and in the process built up large arrears of principal and interest.

External debt increased in real terms from US$19.9 billion in 1985 to US$25.5 billion in 1990. By end 1999, Peru's external debt totalled US$32.3 billion. Peru resumed payments to creditors under Fujimori and in 1996 reached a restructuring deal with the Paris Club[5], followed in 1997 by a Brady-style restructuring of debt with commercial banks. According to the latest EIU report for Peru (2002), the accord reached with the Paris Club covered debt contracted before 1983, which represents US$7 billion of the US$9.3 billion owed, and reschedules payments over 20 years with the annual servicing bill reduced by one half. The Brady deal restructured US$10.6 billion in commercial bank and supplier debt. A further US$2.6 billion of eligible debt was repurchased by the government under a buyback scheme.

Trade

Peru's exports and imports have historically been volatile, owing to both external fluctuations and internal problems. Exhibit 4 shows that during the 70s exports raised around 12% p.a. from US$1,044 million in 1970 to US$3,265 million in 1980, but fell back to US$1,798 million in 1986. Imports were less than exports in 1970, at US$621 million, but tripled over the next five years as a result of the heavy spending of the military government in that period. Imports jumped to US$3,159 million in 1981 as the Belaúnde government liberalised imports and increased its own spending. But these attempts of liberalisation lasted only a few years.

At the end of the decade, in 1989, with the collapse of the economic activity and the regime of high tariffs and import restrictions, imports were pulled back down to US$2,000 million. The same collapse of domestic sales encouraged exports and Peru finished the decade with a trade surplus of US$1,600 million.

The Fujimori government introduced new changes in trade policy in the early 90s towards an opening to global markets. Quantitative restrictions on imports were eliminated and tariffs were reduced[6]. In the early and mid-90s exports rose by 10% p.a. from US$3,312 million to US$5,225 million in 1996. In the same period imports tripled.

But in the second half of 1997 the climatic shock (El Niño) had a very negative effect on Peru's fisheries, agriculture and mining production. In the same period the Asian economic crisis compounded the effects of el Niño and resulted in a souring of Peru's terms of trade (metal prices dropped due to the lower demand in Asia). The Russian crisis in 1998 also hit Peru's economy very hard. Exports dropped by 12% p.a. from 1997 to 1999 and imports decreased by 11% p.a. in the same period.

The economy is highly dependent on imported components for basic manufactured goods, such as consumer electronics and appliances. Industrial inputs – raw materials and intermediate

5 Paris Club debt amounts to approximately 35% of Peru's foreign debt (EIU, 2002).
6 The rate of effective protection for industry was cut from 83% in 1990 to 24% in March 1991.

products – remain the largest category of imports, accounting for some 33% of the total in the first half of this year. Capital goods represented about 30%, and consumption goods made up the balance.

Peru's traditional exports are minerals (46% of total trade in the first six months of 2000), fishery products (traditionally around 20% of exports, fishing dropped down to 3.1% because of the effects of El Niño), agricultural products (4%), and petroleum and petroleum derivatives (4.5%). Non-traditional products – mainly textiles, agricultural products, processed fish products, chemicals, artisan work and some manufactures – make up the remainder (see exhibit 5).

The United States (27% of exports in 2000) is the most important export-trading partner followed by the MERCOSUR and CAN Regions (21%) and the European Union (16%). Within the EU, United Kingdom, Germany, Italy and Spain are the most important export markets (see exhibit 6).

The MERCOSUR and CAN regions account for 38.4% of total imports in Peru followed by the United States with 23.4%. Major imports come from energy and high economies of scale products (related with petroleum) in the MERCOSUR Region. Almost 50% of imports from the United States are high value-added technical products.

1.2. Development Aid

Official aid flows

Net official financing as measured by net flows of ODF (official development finance) increased in real (constant US$ 1999) terms during the last thirty years (see exhibit 7). Accounting for approximately US$1billion annually on average in the 90s, compared with US$653 million during the 80s and US$428 million in the 70s, net ODF reached a high of US$2.2 billion in 1997. In terms of intensity, net ODF per head climbed to US$92.58 in 1997, or 3.9% of GDP.

As shown in exhibit 8, net ODA (official development assistance) accounted for the majority of net official flows over the same period, giving way to other official flows in the latter two sub-periods. Net ODA accounted for 95% of total ODF during 1970-1974, or US$293.8 million, declining to just 35% in 1995-1999, or US$398.6 million. On the other hand, other official flows accounted for just US$15.3 million in 1970-1974 (4.9%), increasing to 65% in 1995-1999, or US$727.8 million. At the beginning of the period, bilateral flows were more important than those from the multilaterals – bilateral flows accounted for 65% of net ODF – increasing in importance over time and finishing roughly equivalent to multilateral flows over 1995-1999.

MAIN TRADING PARTNERS, 2000 (AS PERCENTAGE OF TOTAL)

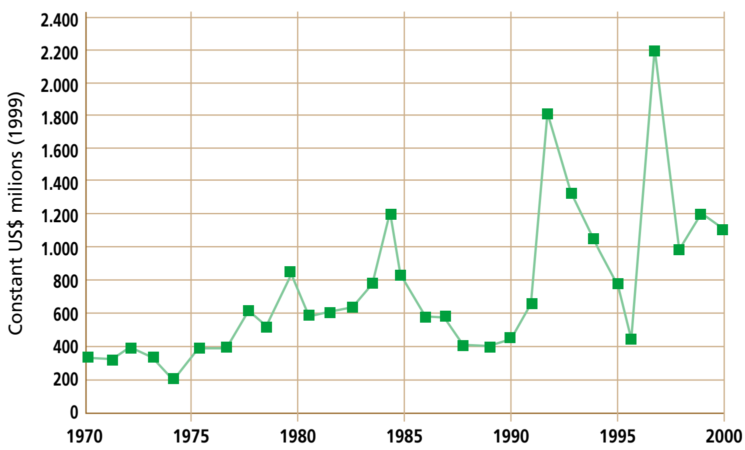
Exhibit: 6

	Exports	Imports
United States	31.0%	23.4%
MERCOSUR Region	21.7%	38.4%
EU	16.0%	12.9%
Japan	5.6%	6.5%
Others	25.7%	18.8%
TOTAL	**100%**	**100%**

Source: Economic Commission for Latin America and the Caribbean (CEPAL)

NET PUBLIC FLOWS EVOLUTION (ODF) IN PERU

Exhibit: 7



Source: Compiled From OECD DAC Online Database

NET OFFICIAL FINANCING MULTILATERAL AND BILATERAL DONORS, (% OF TOTAL)

Exhibit: 8

		1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
Net ODF		**100**	**100**	**100**	**100**	**100**	**100**
	ODA	95	49	59	73	47	35
	OOF	5	51	41	27	53	65
Bilateral		**65**	**72**	**41**	**69**	**80**	**50**
	ODA	98	97	92	94	54	60
	OOF	2	3	8	16	46	49
Multilateral		**35**	**22**	**50**	**31**	**20**	**50**
	ODA	92	46	25	26	18	10
	OOF	8	54	75	74	82	90

Source: Compiled From OECD DAC Online Database

NET OFFICIAL DEVELOPMENT ASSISTANCE, DONOR DISBURSEMENTS (US$ 1999)

Exhibit: 9

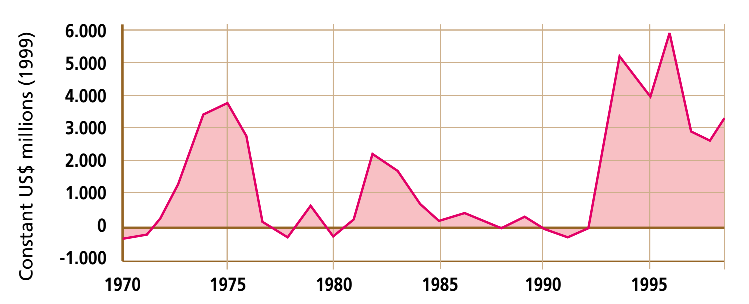
	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
EU members	72.3	106.4	162.5	170.1	169.8	127.8
Japan	69.3	33.7	272.0	222.9	811.3	427.0
US	48.9	55.1	590.2	593.9	432.2	509.0
Other	5.3	14.1	79.7	140.1	150.2	126.5
Total	195.9	209.3	1754.6	1807.4	2242.8	1701.4

Source: Compiled From OECD DAC Online Database

The United States has become the most important donor of official development assistance to Peru. Net flows of ODA from the US increased in real terms from US$48.9 million during 1970-1974 to US$509 million in 1995-1999. EU member countries, which traditionally had been the largest donors contributed approximately the same amount as other donors (Australia, Canada, New Zealand and Switzerland) at the end of the sample period (approximately US$127 million).

NET PRIVATE FLOWS EVOLUTION IN PERU

Exhibit: 10



Source: Compiled From World Bank Development Indicators

AID AS A PERCENTAGE OF GDP

Exhibit: 11

	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99
Aid (% of GDP)	0.8	1.6	2.0	1.6	2.8	2.4

Source: OECD DAC online Database

RATIO OF PRIVATE VERSUS OFFICIAL FLOWS

Exhibit: 12

	1972	1974	1977	1981	1985	1990	1995	1996	1998	1999
Private/Official	0.8	18.6	0.3	0.6	0.1	0.2	5.4	12.3	2.8	2.6

Source: OECD DAC online Database

TOP 10 INTERNATIONAL NGOs IN 1999

Exhibit: 13

Organisation	Country	Amount (US$ million)
CARE	International	23.3
Asociación Intervida	Spain	14.7
ADRA	USA	12.4
Ayuda en Acción, Peru	Spain	6.1
Bilance	Netherlands	4.4
World Vision	International	4.3
Novib	Netherlands	4.1
Misereor	Germany	4.0
Pathfinder International	USA	3.5

Source: Survey, SECTI and ENIEX

Japan has emerged as an important donor over time, accounting for 25% of net ODA in 1995-1999, or US$427 million.

Private Flows

Net private capital flows peaked in 1975 and again in 1982 before escalating in the latter half of the 90s, reaching a period high of US$6 billion in real terms in 1996 (see exhibit 10). The annual average decreased to just US$42 million in the 80s in real terms (constant US$ 1999) before increasing again by US$2.6 billion per annum in the 90s. Net private capital flows reached a high of US$5.8 billion in real terms in 1996. Net private capital flows now account for 6% of GDP, compared to less than 1% at the beginning of the period. In the 90s, portfolio investment flows – equity – helped to drive the increase in net private capital flows and was helped by foreign direct investment flows in the latter half of the 90s.

Role of aid and its effectiveness

Although high amounts of aid have been channelled to Peru over the years, major political interferences and inefficient management of aid within the public administration have had a major negative impact on the country's development. As it shows exhibit 11, aid as percentage of GDP has been relatively important during the reforms of the 90s, accounting for over 2% of GDP. It is also important to mention that during the Asian Financial crisis and El Niño effect in 1997 and 1998, Peru received important amounts of aid in form of emergency assistance.

Private flows have been over the last ten years an important source of financing compared to public aid in Peru, as shown in exhibit 12. The main sources of income have been the privatisations from the telecommunications, energy, banking and mining sector.

The IFIs, in particular the World Bank and the IADB, have provided important amounts of aid over the years. The main areas of involvement over the last ten years have been: education and health, building of basic infrastructure (roads, etc.) and supporting the judiciary reform (see appendix 1). Lately these institutions have also been supporting institutional strengthening initiatives for the public administration. Donor funds are utilized as a part of the general budget in Peru to enable the effective support of national strategy.

Aid and NGOs in Peru

NGOs in Peru are important social actors in development. They are perceived as an efficient service reaching the poor, improving their lives while at the same time identifying real local needs. A World Bank report on Peru in 1996 stated that NGO-administered programmes had a significantly better targeting record than most public programmes[7].

According to SECTI (Agencia Peruana de Cooperación Internacional) there are currently around 2,800 NGOs in Peru:

- 2,150 of them are registered with the SECTI
- Around 120 are international NGOs
- Around 530 NGOs are not registered in the SECTI database

The main areas of activity of these NGOs are:

- Rural development (especially undertaking many alphabetisation programmes)
- Education/Training programmes in different areas for professors and teachers

In Peru, as well as in many other developing countries, an important part of NGO funds come from public sources (ODA). With the participation approach in development, IFIs and bilaterals are increasing their grants to NGOs and are also outsourcing the implementation of some of their own projects to NGOs.

NGOs in Peru have an active role in the participatory approach on poverty reduction and are improving their management. In 1996 the World Bank together with the UNDP and The Inter-American Foundation launched a regional programme for poverty

7 World Bank, Poverty and Social Development in Peru, 1994-1997

reduction based on alliances between the government (local, regional and national), enterprises and NGOs. They included two types of alliances: those for long-term strategy definition and those for specific actions. Until now, this participatory approach to development has been very successful. NGOs have benefited from these alliances by improving their management and their inter-institutional and multisectoral coordination[8].

The collaboration of international NGOs in Peru, according to a study conducted by the COEECI (Coordinadora de Entidades Extranjeras de Cooperación Internacional), reached US$149 million in 1998 and US$153 million in 1999 (see exhibit 13). This amount should be higher as it does not include funds directly sent to local organizations with small projects. These organisations contribute to poverty reduction and the improving of living standards and they can be divided into: 1) church-related NGOs such as MISEROR in Germany or Catholic relief in USA and 2) Human assistance NGOs such as CARE in USA or OXFAM in the UK.

Some of these international NGOs act simply as financiers of projects implemented by local NGOs, while others implement their projects themselves directly and others still have a mixed formula.

International NGOs in Peru have diverse sources of funding. Some of them base their funds on voluntary work but the majority has private donations in the form of annual subscriptions. Since the mid 90s NGOs have been receiving grants from public sources (ODA). For example, Germany and the Netherlands channel an important part of their development aid through NGOs.

As shown in exhibit 14, international NGOs concentrate their main activities in the following areas: education, health, farming, infancy, the environment, nourishment and gender. Most of their projects are concentrated in the capital Lima and in Cusco.

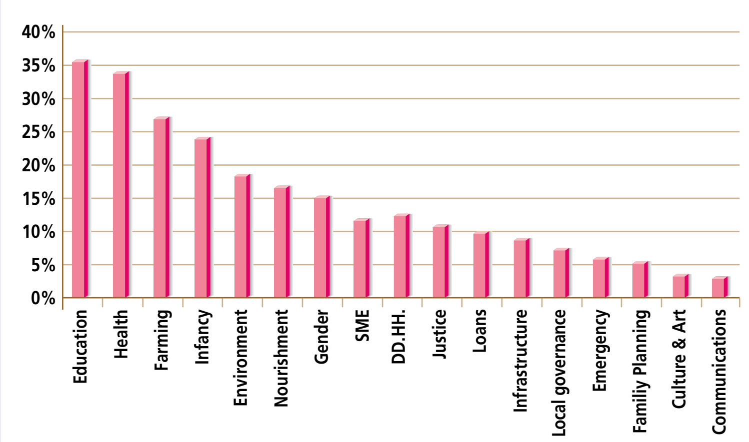
1.3 Poverty reduction

According to the IADB, more than half of Peruvians (54.1%) live in poverty and 14.8% in extreme poverty. The situation is worse in the rural areas where 2 out of 3 Peruvians are poor (twice the level of metropolitan Lima). Poverty in the rural areas has worsened over the last years (see exhibit 15), reflecting the failure of the attempt by the Peruvian government to target social investment to the poor (World Bank, 1999).

Nevertheless, a selection of social indicators for Peru (see exhibit 16) over a twenty-five year period indicates an improvement over time. Infant mortality has declined from a rate of 96 per 1,000 births in 1975 to just 39 per 1,000 in 1999.

MAIN AREAS OF ACTIVITY

Exhibit: 14



Source: Survey, SECTI and ENIEX

POVERTY INDICATORS - PERU

Exhibit: 15

Poverty incidence (%)	1994	1997
Lima	22.5	20.2
Other urban	33.1	32.6
Rural	44.3	47.1

Source: World Bank

SOCIAL INDICATORS IN PERU

Exhibit: 16

	1975	1985	1995	1999
Infant mortality rate (per 1,000)	96	72	43	39
Life expectancy at birth (in years)	57	63	68	69
Primary school enrolment rate (in %)	113.5	120.5	122.9	n.a.
Secondary school enrolment rate (in %)	45.5	62.8	69.7	n.a.
Adult illiteracy rate (in %)	24.3	17.2	12.1	10.3
Immunization DPT (% children under 12 months)	n.a	48	95	98

Source: Compiled from World Bank Development Indicators, various

COMPARATIVE PERFORMANCE, 2000

Exhibit: 17

	Peru	LAC	Lower middle income countries
Population (million)	25.7	516	2,046
GNI (Atlas method, US$ billion)	53.4	1,895	2,327
GNI per capita (atlas, US$)	2,080	3,680	1,140
Poverty (% population below national poverty line)	54	n.a.	n.a.
Urban population (% of total)	73	75	42
Infant mortality rate (per 1,000)	69	70	32
Life expectancy (years)	39	30	69
Access to improve water source (% of population)	77	85	80
Adult illiteracy rate (% of population)	10	12	15
Gross primary enrolment (% school age population)	123	113	114

Source: World Bank

Similarly, the life expectancy at birth has improved for Peru. Primary and secondary school enrolments have increased over the last 30 years and remain above those for the LAC region and the least developed economies as a whole.

Peru's relative performance compared with similar countries

As the data in exhibit 17 shows, the adult illiteracy rate in Peru has been similar to the LAC region as a whole and marginally lower for most of the selected years. For

8 World Bank, Seminario " Construccion de Alianzas para Promover el Desarrollo local"

the years in which data are available, the immunization rate for DPT in Peru has been marginally better than that for the region and appreciably better than for the least developed countries group.

2. INSTITUTIONAL INFRASTRUCTURE

2.1 Political System
(Overall rating 3)

2.1.1 and 2.1.2 The Rules and the Structure

The 1993 constitution, Peru's fifth, was ratified following the self-coup (autogolpe) of Mr. Fujimori in April 1992 and in response to pressure from the international community for a return to democratic rule (EIU, 2002). This most recent constitution replaces the one of 1979. The president of the Republic is popularly elected for a five-year term, and the 1993 Constitution permits re-election. The first and second Vice Presidents are also popularly elected. The principal executive body is the Council of Ministers, headed by the President of the Council. The Premier and the Cabinet are appointed by the President. All Presidential decree laws or draft bills sent to Congress must be approved by the Council of Ministers. The Congress is composed of 120 members elected for a five-year period. In addition to passing laws, Congress is empowered to approve treaties, authorise government loans, and approve the government budget.

The role of the executive[9] and "on paper" independence of the judiciary were strengthened under the 1993 constitution. However, the legislature was curtailed and a re-centralization of decision and power was introduced by Mr. Fujimori – made possible by the boycott of Congress by the main opposition parties enabling Mr. Fujimori to pass several controversial changes.

Exhibit 18 below shows the Peruvian governmental system today (Legislative, Executive and Judiciary).

Given the political developments that took place in the final years of the last decade (see below), there is support for a new constitution that would build on the democratic reforms implemented by Congress in late 2000 and into 2001.

- The national list system of elections has been replaced by a multi-district electoral system, with seats assigned to specific areas.
- Political parties now need signatures from just 1% of the electorate (roughly 120,000 voters) as opposed to 500,000 voters.
- An immediate re-election of the president is no longer possible and the state cannot carry out any advertising once an election date has been set.
- All findings of the Inter-American Court of Human Rights, ignored by Mr. Fujimori, will be ratified.
- Greater broadcast freedom has been achieved, with the return of channels 2 and 13 and of the Frecuencia Latina station to their owners.

2.1.3 Management

Although Peru has conducted democratic elections since the 80s, allegations of corruption and abuses of power have arisen in the political system.

Democratic elections

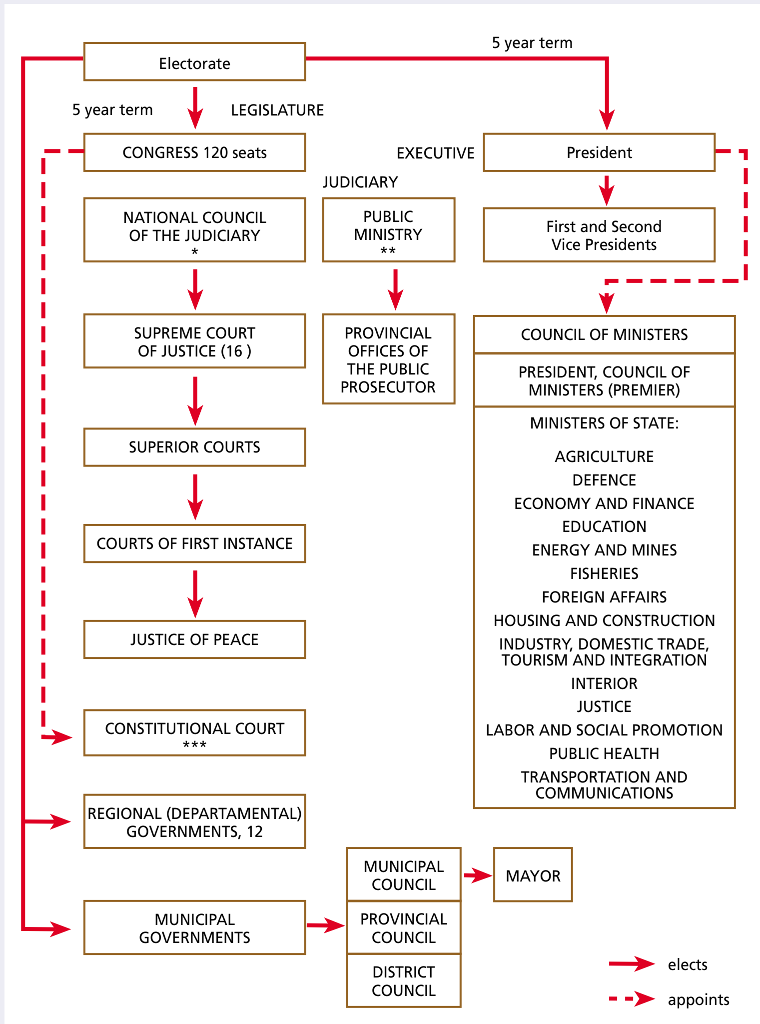
Suffrage is universal and obligatory in Peru. National and local-level elections were largely considered free and fair throughout the 80s, although there were numerous technical difficulties such as inaccuracies in the voter registration rolls and high levels of nullified votes. Nevertheless, no electoral outcome was seriously contested and no sectors of the population were formally excluded from participation.

This situation changed over the 90s. Suspicion that the government had not played fair in the 1992 congressional elections or the 1993 referendum undermined public trust in the government entities responsible for guaranteeing the transparency and validity of the electoral process, which led to a call for domestic and international observers to monitor the 1995 elections. Observers conceded those elections were free and fair, but there were enough irregularities in the preferential vote to cast doubts on the government's parliamentary majority.

In 1999, Fujimori formed a four-party coalition – Peru 2000 – with pro-government organisations, Cambio 90,

GOVERNMENTAL SYSTEM OF PERU

Exhibit: 18



* Autonomous entity with 7 members elected for 5 years; by Supreme Court of Justice (1), Board of Supreme Pro-sectors (1), Bar Association (1), other legal professional associations (2), presidents of the private universities (1)
** Autonomous entity with Public Prosecutor elected for 3-year term by Board of Supreme Prosecutors and prosecutors appointed by National Council of the Judiciary
*** Autonomous entity with 7 members appointed by Congress for 7-year terms

Source: DFC Analysis from various sources including the 1993 Constitution

9 This was clearly demonstrated in 1999, when Mr. Fujimori overruled the constitution in order that he could stand for president for a third term.

Nueva Mayoria, Vamos Vecino and the Frente Nacional Independiente Peru 2000 and sought an unprecedented third term in office. By the time President Fujimori declared his candidacy for a constitutionally dubious third term (2000-2005), public confidence in electoral institutions was very low indeed, precipitating another call among opposition leaders for international observers to monitor the 2000 campaign and the vote on election day. The resulting process was one of the most questioned and problematic in Peru's history, marred by abuses of power by the Executive and ruling party in their effort to remain in power for a third consecutive term.

Allegations of corruption and bribery prompted Mr. Fujimori to call for elections in 2001. He announced that he would not contest these and would resign as president while in Japan, where he gained citizenship. The interim government under Valentín Paniagua resolved to organize free and fair elections. Mr Toledo won these in the second round of voting in June 2001. A minority government was formed, occupying just 45 seats in a 120-member Congress.

Centralization

Peru suffered from an excessive centralization of power under Mr. Fujimori's rule during the 90s, with Mr. Fujimori's government acting in authoritarian style. In 1992, in the face of mounting opposition to his economic policies, he closed Congress and suspended the judiciary. The new constitution, ratified in 1993, reduced the power of the legislature and reinforced centralism. The ruling administration worked hard to dispel widespread dissatisfaction with the government and its abuse of power as seen by the excessive centralization, the subordination of democratic institutions, such as the judiciary and electoral tribunal, Congress and the media and allegations of corruption in the customs service.

The IADB seems to be well aware of this issue and it is focusing its 2002 strategy on modernizing the public administration through institutional strengthening and decentralization. Nevertheless, current local authorities do not have the human and financial resources to decentralize.

Aid Management

The Investment Office (Oficina de Inversiones) within the Ministry of Economy and Finance is responsible for the management of all public funds including official flows from donors. During many years political interferences were linked to this office (see section 2.4.3).

2.2 Legal Framework
(Overall rating 2)

Peru follows a traditional tripartite model of government with three autonomous branches of government (Executive, Legislative and Judicial). Like certain Latin American countries however, this constitutional equality is not realized in practice and the government is characterized by strong Executive and weak Judicial branches.

2.2.1 and 2.2.2 The Rules and the Structure

The 1993 constitution ensures the independency of the judiciary. The judicial sector in Peru comprises the following: the Judiciary, formed by the Supreme Court, Superior Courts or Courts of Appeal, Specialized Courts or Courts (Juzgados) of First Instance, and Justices of the Peace (both professional and lay judges); the Ministry of Justice; the Public Ministry, the National Council of the Magistrate; the Academy of the Magistrate; the Office of the Public Defender and the Constitutional Tribunal.

The Supreme Court serves the whole nation, while each judicial district has a Superior Court. Under the Superior Courts are first instance courts and a small number of "professional" Justices of the Peace. There are presently some 1,500 professional judges throughout the country. "Lay" justices of peace amount to about 4,300. They serve as a real conciliatory justice for small claims.

The Academy of the Judiciary (Academia de la Magistratura, or AM) is a separate unit within the Judiciary charged with the education and training of judges and prosecutors at all levels. Its Charter specifies three distinct purposes of training: (i) prepare aspiring judges and prosecutors for judicial duties; (ii) upgrade the skills and knowledge of existing judges eligible for and seeking promotion; and (iii) provide continuing legal education for all judges.

The National Council of the Judiciary (Consejo Nacional de la Magistratura, or CNM) is a separate institution originating from the 1993 constitution. Its mandate is to select, appoint, ratify and remove judges and prosecutors at all levels. With clear autonomy in the naming of judges, the CNM is intended to be a key element in assuring the independence of the Judiciary. The CNM directly appoints all judges, without any presidential or congressional intervention. Also, the CNM is responsible for ratifying judges every seven years and is endowed with the capacity to remove Supreme Court judges.

The Office of the Public Defender (Defensoria del Pueblo, or DP) is a constitutional level ombudsman charged with the defence of the fundamental rights of citizens and the supervision of compliance of the public sector with its legally-defined responsibilities. An autonomous body, elected for a five-year term by Congress, the DP is required to submit an annual report to Congress. The first DP was appointed by Congress in April 1996, and initiated its activity in September 1996.

The Tribunal of Constitutional Guarantees (TCG) adjudicates constitutional issues. It also has jurisdiction over legal actions invoking constitutionally-guaranteed actions whereby a citizen may allege the violation of a constitutional right by the authorities or by another private citizen. After some delays, all the seven positions were appointed by Congress in June 1996, and the TCG started its activity in October 1996.

The Ministry of Justice provides the link between the Executive and other branches of government on all matters related to the judicial sector. As such, it is the Executive's arm for interacting with the Judiciary. The Public Ministry represents judicial processes of the society. Criminal prosecution involves the bulk of the cases involving the Public Ministry.

2.2.3 Management

The judicial system in Peru largely shows an inadequate performance when measured against basic standards and principles of independence and accountability, access, efficiency and professional competence and integrity.

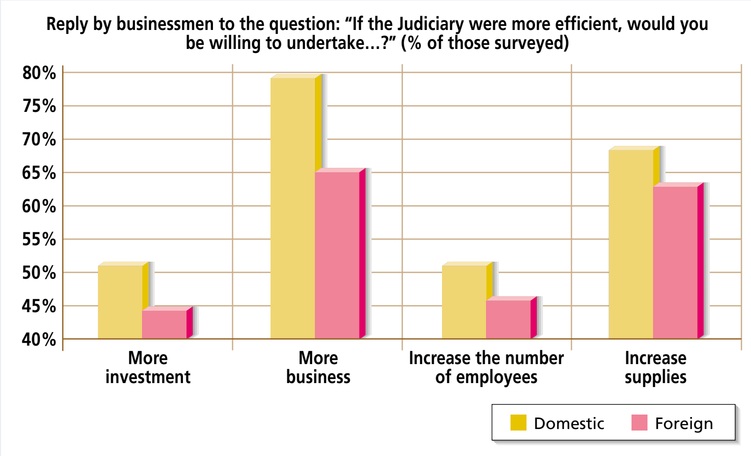
Status of development of legal framework compared to international standards

According to the World Bank's Judicial Reform Project Appraisal Document of 1997, "the Peruvian judiciary is behind the times. Profound reforms are required in the justice system in order to facilitate the consolidation of economic reforms, encourage the productivity of enterprises and foster the integration of the poorest people into the productive process. Without a solid and respected justice system capable of guaranteeing in practice security of person and property, the aspirations of people, especially the poor, to participate in the benefits of economic and social opportunity cannot be fulfilled and private sector development is discouraged". The project was never implemented due to political interference by the Fujimori government in the Judiciary, but the same problems persist today, that is: the judicial system in Peru largely shows an inadequate performance when measured against basic standards and principles of independence and accountability, access, efficiency and professional competence and integrity. This results in a system with very low public trust and confidence.

The World Bank loan was to help finance consulting services, training, equipment, and physical infrastructure improvements. According to Bank

IMPACT OF THE MODERNIZATION OF THE JUDICIARY ON THE ECONOMY

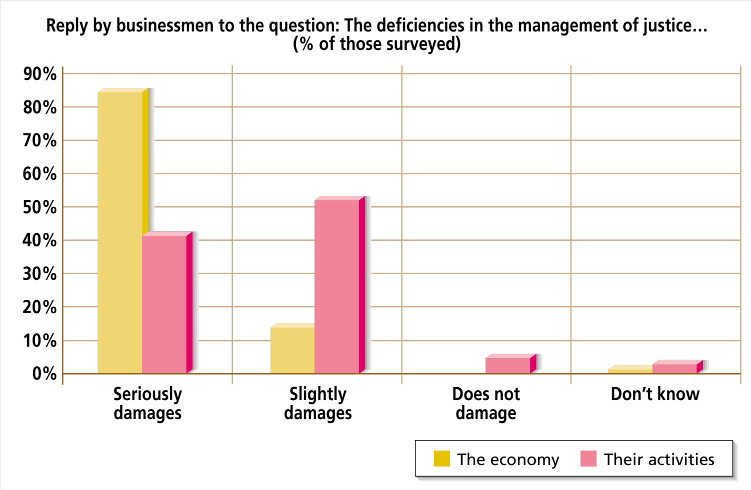
Exhibit: 19



Source: Study by Instituto APOYO: "The impact of the Judiciary in business decision making in Peru"

DAMAGE CAUSED BY JUDICIAL INEFFICIENCY ON ECONOMIC ACTIVITY

Exhibit: 20



Source: Study by Instituto APOYO: "The impact of the Judiciary in business decision making in Peru"

documents, the Project was to focus on three areas that overlapped significantly with the Fujimori government's existing reform initiative: administration of justice, access to justice, and judicial selection, training, and evaluation.

- The administration of justice component would concentrate first on strengthening the general management capacities of the Supreme Court and the Superior Courts, through management training and a new management information system. It also would contribute to improving the performance of lower courts through training, better information systems and physical improvements.
- The access to justice component would provide training to justices of the peace, reform the justice of the peace system, create a fund for NGO involvement, and supply funding to the Office of the Public Defender (a national ombudsman's office responsible for defending the fundamental rights of citizens).
- The judicial selection, training and evaluation component would support key activities of the National Council of the Judiciary (CNM) (responsible for the selection, periodic ratification or removal of judges and prosecutors), the Judicial Academy (responsible for judicial and prosecutorial education and training), and the Office of Judicial Supervision (responsible for judicial discipline), respectively.

According to the World Bank's Lima office, the Bank has initiated steps to revive the judicial reform loan, in view of the present government's commitment to eradicate corruption and to stop political interference in the judiciary.

Quality of the Judicial System

The basic objectives of reform, proposed by the Bank (but still not launched) as well as other more recent projects such as that promoted by the Peruvian "Instituto de Formación Bancaria", is to create a Judiciary which displays the following characteristics:

- Judicial decisions are undertaken efficiently and in a timely fashion;
- Judicial decisions respond to homogenous criteria and are predictable;
- Members of the Judiciary are honest;
- Justice is easily available to all.

The Peruvian judiciary still does not display any of these characteristics today. There are considerable backlogs of cases pending in the courts and in commercial cases such as the legal enforcement of guarantees, these usually take up to 24 months to be resolved. Many decisions are erratic and contradictory.

According to the "Instituto de Formación Bancaria", the lack of efficiency in the judiciary in Peru has had a direct negative impact on economic transactions and is impeding economic development. Exhibit 19, elaborated by the "Instituto Apoyo" for the "Instituto de Formación Bancaria", shows the results of a survey of the actions that Peruvian companies would be willing to undertake if the Judiciary were to undergo reform.

As can be observed, 79% of Peruvian businesses and 65% of the foreign businesses are of the opinion that they would increase their business if the judiciary were managed more efficiently. The Instituto APOYO also interviewed the top 1,000 companies in Peru, who were of the opinion that the inefficient judiciary seriously damages the Peruvian economy, as can be observed from the chart in exhibit 20.

2.3 Financial System
(Overall rating 4)

2.3.1 The Rules

The Reserve Bank of Peru, created on March 9, 1922, became the Central Reserve Bank of Peru (BCRP) on April 28, 1931. The constitution establishes two aspects of monetary policy: central bank autonomy and preserving monetary stability. It defines the duties of the BCRP as the regulation of the money supply, management of international reserves, issuance of notes and coins and provision of periodic information on the nation's finances (for additional information on the financial system refer to appendix 2).

2.3.2 The Structure

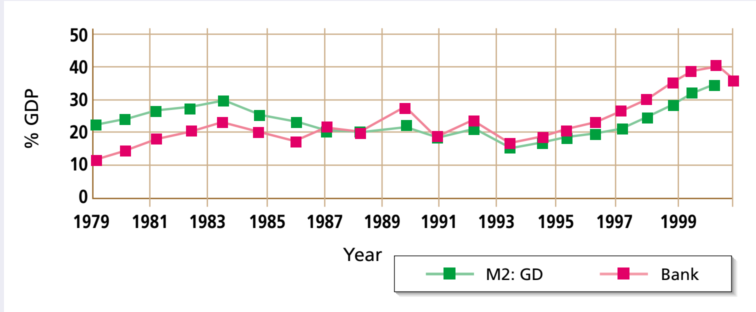
The BCRP has seven regional offices – Arequipa, Cusco, Huancayo, Iquitos, Piura, Puno and Trujillo – in addition to its main headquarters in Lima. A board made up of seven members, three appointed by the legislative branch and four by the executive branch, governs the BCRP. One of the executive branch appointees becomes chairman of the board and must be ratified by Congress. The chairman also acts as governor of the International Monetary Fund and as alternate governor to the World Bank.

Peru has a strong banking superintendency, the "Superintendencia de Banca y Seguros", which is presently seeking to encourage further consolidation in the sector (EIU, 2002). The IMF and World Bank recently completed an FSAP mission to Peru. Although the results of the study have not been published, the most recent IMF country report (February 2002) states that the Peruvian authorities were not ready to specify the steps they would take to follow the FSAP's recommendations. The FSAP recommended that the authorities broaden the use of explicit time limits for the capitalization of weak banks and improve the SBS's power to take remedial action in cases of persistent bank liquidity problems (IMF, 2002).

By end 2000, the Lima Stock Exchange had 230 listed companies of which 14 only had listed debt instruments. Although the stock exchange is perceived to be relatively efficient (in fact, it introduced electronic trading in 1995 and almost 50% of all listed stocks are dematerialised), its annual trading volume is small (approximately US$700 million).

INDICATORS OF FINANCIAL DEPTH

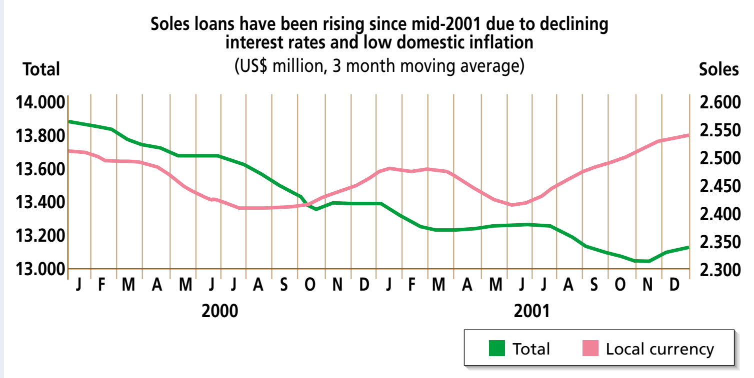
Exhibit: 21



Source: Compiled From International Financial Statistics: IMF

BANKING SYSTEM CREDIT TO THE PRIVATE SECTOR

Exhibit: 22



Source: Apoyo Consultoría from BCR statistics

2.3.3 Management

The financial system in Peru endured important crises during 90s. Nevertheless, the country was able to recover as is shown by the recent growth and success of institutions that are focused on small and micro businesses.

According to the latest EIU report for Peru, the banking system was in crisis in 1990. This stemmed from the mass withdrawal of foreign banks due to discriminatory legislation and hyperinflation, while capital flight reduced the volumes intermediated by commercial banks to a third of their mid-80s levels and non-performing loans increased to a quarter of loan portfolios. Both broad money and commercial bank assets as relative proportions of GDP declined in the first half of the 90s (see exhibit 21). During this time, Mr. Fujimori closed the state's development and mortgage credit banks, leaving just the Corporación Financiera de Desarrollo (Cofide – the state development agency), a second tier bank, channelling funds from other institutions. More recently, the authorities created a state-supported 'agrarian bank' to help the agriculture sector. Based on strong political support, including that of the President, the perception was that the private sector banks were not doing enough for the small and medium-size agricultural producers.

Economic recovery and capital inflows to the financial system helped to improve Peru's banking sector from the mid-90s, building on the reforms introduced from 1993 that included new legislation and privatisation. Both the ratio of commercial assets to GDP and M2 (broad money) to GDP increased in this period. The incidence of non-performing loans also increased in this period – accounting for over 11% of credit loaned by the banks in 1998 compared with 6.1% in previous years, hinting that the increase in commercial bank assets to GDP ratio may have been too rapid. However, this period also coincided with the debt crisis in Russia, from which the fall-out impacted heavily on the banking sector, contributing to an increased level of non-performing loans (NPLs).

According to Central Bank figures, loans decreased by 1.6% in 2001, for the third consecutive year, as the figure in exhibit 22 shows.

Peruvian banks developed adequate financing to SMEs and individuals. While overall loan growth continues to be negative, the breakdown by banks shows significant growth (see exhibit 23) for entities specialising in consumer loans and small businesses (Mibanco, Banco del Trabajo), as well as those in corporate banking (Bank Boston, Citibank), where competition for clients is more aggressive. The larger banks, in particular Crédito, in which loans to medium-sized companies are a larger part of their portfolio, showed negative loans growth which, given their size, weighed heavily on the growth of total loans for the system.

The quality of bank loan portfolios continues to improve. At end 2001 past-due loans were down to 9% of total loans, returning to 1999 levels. NPLs and restructured loans stabilized at 17% of total loans. The improvement in loan portfolio quality has been unequal across banks (see exhibit 24) with larger banks focused on corporate clients improving the most. Many banks have seen the quality of their loans portfolio continue to deteriorate over the last year. Of relevance, nevertheless, are the low bad debt ratios of Mibanco and El Banco del Trabajo.

Recent reforms undertaken

The recent growth and success of institutions that are focussed on small and micro businesses are a good example of the benefits that can be derived from providing the right regulatory framework which encourages formalisation. The 1997 banking law permitted the creation of EDPYMES (Development Institutions for SMEs) and enabled the formalisation of NGOs which had been undertaking micro lending activities, by lowering the barriers to entry (mainly capital requirements) into regulated banking. It additionally has had the benefits of providing access to COFIDE funding on the one hand and of motivating the formal banking sector to

EVOLUTION OF TOTAL LOANS (US$ MILLION)

Exhibit: 23

	Dec 2000	Dec 2001	Difference	% Chg.
Banks that grew over 5%	**990.4**	**1206.7**	**216.3**	**21.8**
Mibanco	36.9	61.4	24.5	66.4
Del Trabajo	90.0	120.3	30.2	33.6
Financiero	204.5	268.2	63.7	31.1
Bank Boston	171.2	212.5	41.4	24.2
Citibank	475.1	530.6	55.5	11.7
BNP-Andes	12.7	13.6	1.0	7.8
Banks that grew under 5%	**2925.0**	**2955.1**	**30.0**	**1.0**
Sudamericano	461.4	480.7	19.3	4.2
Interbank	836.7	842.3	5.6	0.7
Continental	1626.9	1632.0	5.2	0.3
Banks that reduced under 5%	**5151.3**	**5073.0**	**-78.4**	**-1.5**
Wiese-Sudameris	2325.7	2305.6	-20.1	-0.9
Crédito	2825.6	2767.4	-58.3	-2.1
Banks that reduced over 5%	**1497.2**	**1372.4**	**-124.8**	**-8.3**
BIF	262.8	246.5	-16.3	-6.2
BSCH	970.2	899.6	-70.6	-7.3
Comercio	182.3	161.2	-21.1	-11.6
Standard Chartered	81.9	65.1	-16.9	-20.6
TOTAL	**10563.9**	**10279.1**	**-284.9**	**-2.7**

Source: SBS

PORTFOLIO INDEX EVOLUTION 1/ (%)

Exhibit: 24

	Dec 2000	Dec 2001	Difference (% points)
Banks with improval in the portfolio			
Santander	13.2	9.7	-3.52
Citibank	4.8	2.7	-2.08
Continental	8.9	7.0	-1.91
Crédito	11.2	9.5	-1.69
Interamericano	5.4	3.9	-1.45
Sistema	9.8	9.0	-0.79
Interbank	11.7	11.2	-0.50
Bank Boston	0.7	0.7	-0.03
BNP Andes	0.0	0.0	0.00
Banks with portfolio deterioration			
Standard Chartered	9.7	10.3	0.59
Sudamericano	5.2	6.2	0.99
Del Trabajo	4.7	5.8	1.06
Mibanco	1.7	2.8	1.12
Financiero	7.0	8.6	1.59
Comercio	9.8	11.6	1.85
Wiese	9.9	12.5	2.62

Source: Apoyo Consultoría from BCR statistics

1/ Past due loans over total loans

downscale and initiate lending to the "real economy" on the other.

In terms of total assets, the EDPYMES grew by 52% between end 2000 and end 2001, the Municipal Savings Banks (CM) by 34%, and the Rural Savings Banks (CRAC) by 14%. EDPYMES bad debt ratios grew from 7% to 8% over the same period, but continue to be low compared to the universal banks, while the ROEs of the micro lending institutions increased satisfactorily in 2001. The CM reached 29% by end 2001, the ROE of the CRAC and the EDPYMES was 6% and 5% respectively, representing an increase of 4 and 3 percentage points with respect to end 2000.

2.4 Corporate Governance *(Overall rating 3)*

2.4.1 and 2.4.2 The Rules and the Structure

The 1993 Constitution describes the country's Auditor General Office ("Controlaria Pública") as: "a decentralised public entity, the highest authority of the National Audit System (" Sistema Nacional de Control")". It supervises the legality of the execution of the State Budget, of public debt and of the actions of the institutions under its control. The objective of the "Sistema Nacional de Control" is to periodically evaluate the results of state management with respect to the criteria of economy, efficiency, effectiveness and transparency against fulfilment of norms and proposed goals.

The Auditor General is appointed by the government for a term of seven years and can only be removed by Congress for grave misdemeanours. The office cannot be said therefore, particularly in the light of events during the Fujimori government, to be entirely independent (especially if Congress is dominated by the government).

The "Sistema Nacional de Control" is in charge of auditing the following organisations:

- the Legislative,
- the Judiciary,
- certain sectors of the Executive,
- the Regions,
- Municipalities, and
- Autonomous Organisms, etc.

2.4.3 Management

While political interference has generally been prevalent in public finance in Peru, particularly during the Fujimori administration, progress has been made in improving the technical evaluation of all public investments. Political interference in the technical or objective decision-making process with respect to public investment selection has historically taken place. Prior to 2000, only those public investments which were funded by external donors were subject to a feasibility / cost-benefit study. After that year all investments, both domestically and externally funded, became subject to such viability tests. In addition, all projects may be reviewed and compared to original objectives. According to the Public Investment Office of the Ministry of Finance (Oficina de Inversiones, or ODI), at least 25 projects were deemed to be unviable in 2001 alone. Even projects funded by the major donors (with the exception of the World Bank, which does undertake thorough feasibility analysis and post disbursement control of all its projects), have suffered problems, both in terms of implementation feasibility and real priority. A major reason for this is the trust placed by the donors in their capacity to select priorities and to manage projects. The latter has been an illusory capacity, as political appointments to projects managers have historically been too often the case.

Application of the Principles of Corporate Governance (Private)

In the private sector, corporate governance in Peru is deemed to be at a similar level to that compared to neighbouring countries. A recent study by Crédit Lyonnais Emerging Markets classified Peruvian corporate governance as above average, as the following exhibit 25 shows, as is shown in exhibit 25.

Nevertheless, despite Peru's relatively good positioning, especially with respect to the general adoption of international accounting standards, such issues as the protection of minority interests are not well developed. With that end in mind, the Peruvian securities commission, the CONASEV, recently reviewed and evaluated the legal framework and introduced proposals in order to provide greater protection for shareholders. This is due to the fact that the majority of

Peruvian companies are characterized by their family shareholdings and the law has until now been focused on "closed companies" and did not introduce mechanisms of control over management, protection of minority shareholders nor the obligation to inform shareholders.

2.5 Trade and Competition *(Overall rating 4)*

2.5.1 and 2.5.2 The Rules and the structure

Trade policy is determined by the Ministry of Economy and Finance and adherence to customs and tariff regulations is overseen by the Superintendency of Customs through its nations-wide delegations.

Several changes in the rules for enforcing foreign-trade legislation have recently been introduced. These include rules for customs warehouses, changes in the rules for the General Customs Law, container rules, household-luggage rules and drawback rules. In addition, the Law of Customs Crimes (Law 26461) was approved in 1995. These measures were introduced to make imports slightly less attractive, to help close the trade deficit.

Nevertheless, the Fujimori administration was committed to tariff reduction as a way of benefiting domestic consumers and enhancing the competitiveness of local producers. The administration cut tariffs substantially, most set at a fixed 15%. Plans to introduce a universal 15% flat tariff by the end of 1996 stalled because of concerns over protecting key industries and there have been no further attempts to implement the universal tariff.

Peru is also a founding member of the WTO, and as a result WTO regulations (service market liberalisation, antidumping, etc.) are applicable in Peru. In addition, the Peruvian government has made several trade agreements in order to gain access to international markets:

- Andean Investment Act (ATIA), which enables the duty free import of Bolivian, Colombian, Ecuadorian and Peruvian Products to the US.
- Andean Community (CAN). Peru maintains a duty free zone with Bolivia for most of its products. Peru and the rest of the member countries (Colombia, Ecuador, Bolivia, and Venezuela) have agreed to reduce custom duties levied on the trade of goods among such countries.
- Southern Common Market (MERCOSUR). Partial agreements have been executed by the Peruvian government with each of the member countries (Brazil, Argentina, Paraguay and Uruguay). The members of the Andean Community are working together in the implementation of a trade Agreement with MERCOSUR.

CORPORATE GOVERNANCE CLASSIFICATION BY COUNTRY

Exhibit: 25

Country	Norms & Regulations	Obligatory nature of regulations	Political/ regulatory environment	Adoption of International GAAP	Institutional mechanisms/ CG culture	Average
Chile	8	6	6	7	6	6.4
Mexico	6	5	6	8	6	6.1
Peru	7	5	5	7	4	5.4
Argentina	7	5	5	6	4	5.2
Venezuela	6	4	5	7	3	4.8
Colombia	6	4	5	7	3	4.8
Brazil	6	3	4	7	5	4.7

Source: CLSA Emerging Markets

2.5.3 Management

Peru's customs is an outstanding example of the benefits that institutional management reform can bring. According to a study published in 1999 by Michael Lane, H., International Supply Chain Management and Customs: Peru – a Case Study, the management of Peruvian customs in 1991 could not have been worse:

"In 1991 Customs in Peru could be described as follows:

- A poorly equipped and trained staff comprised of only 2% professional employees.
- High and complex tariffs with 39 duty levels ranging between 10 and 84%.
- Out-dated customs laws and regulations not in conformance with international customs conventions.
- Clearance times for customs processing that ranged from 15 to 30 days.
- Antiquated customs procedures, minimal documentation, extensive individual officer discretion, and a lack of transparency.
- Manual, paperwork intensive systems, and an inspection rate of 70-100%.
- Unlimited discretion of officers working in the 19 ports resulting in a lack of uniformity.

In addition to these problems the poorly trained and underpaid staff was corrupt and the system operated on bribery. Revenue collections, even in an environment of excessively high duties, fell far short of amounts due although there was no system to measure the extent of leakage and shortfall."

In sharp contrast to the 1991 situation, Lane praises the results of a five-year transformation programme with the following conclusions:

"The example of Peruvian Customs clearly demonstrates that even the most corrupt and inept of Customs Administrations can be transformed into a world-class organization in a relatively short period of time. Progress in Peru was immediate, incremental and continues to this day. Today, Peru is a much more desirable environment for business and investment. Peruvian Customs has reduced the transaction costs for operating in Peru. The following summarizes the results of the reform comparing 1990 to 1996:

- The value of imports into Peru increased by almost 100% from US$4 billion to US$7.5 billion.
- The tariff was simplified and duty rates were lowered significantly from 39 levels between 10-84% to 2 levels at 15-25%.
- Collections increased from US$626 million to US$2723 million in spite of a reduction in staffing and reduced inspections and lower duty rate.
- Customs' contribution to national revenue collections in Peru increased from 23% of total revenues to 35%.
- Staffing was reduced by approximately 30% from 3,800 to 2,600.
- Cargo inspections were reduced from a level of 70-100% to a maximum of 15%.
- Cargo release times were reduced from an average of 30 days to one or two days for red channel cargo (i.e. cargo to be inspected) and frequently same day release for green channel cargo.
- Manual processing and a paper-based system were replaced by an automated system with direct deposit of collections into banks by customs agents.
- Inconsistent, non-uniform, and undocumented customs processes were replaced by documented systems and published regulations."

Trade and Competition is monitored and promoted by the "Dirección general de asuntos de economía internacional, competencia e inversión privada" of the Ministry of Economy and Finance. It is widely perceived to be well intentioned but ineffective given the weak judicial system.

3. CONCLUSIONS

Real GDP growth has been erratic in Peru since the 70s and although the economy saw strong growth during most of the 90s it was hard hit by the international financial crisis and the effects of El Niño. In any case, Peru's GNP per capita for the year 2000 of US$2,080 compares to an average of US$3,680 for Latin America and the Caribbean as a whole and as mentioned above, over 54% of all Peruvians live in poverty, despite the fact that public flows of aid averaged US$1 billion and net private capital flows averaged US$1.2 billion during the 90s.

As can be seen from the analysis of Peru's Institutional Infrastructure, its rules, structure and above all its management have had a strong negative impact on the country's development. The management scorecard (section 4) shows that only the Financial System and Customs (Trade and Competition) merit a score above a very low 2.

The Political and Judicial Systems: The 1993 Constitution establishes a traditional tripartite model of government with three autonomous branches of government (Executive, Legislative and Judicial). Like certain Latin American countries, however, this constitutional equality is not realised in practice and the government is characterised by a strong Executive Branch and a weak Judicial Branch. The constitution was designed to provide more efficiency in government and greater autonomy to the Judiciary. Its "on paper" rules and structure therefore merit an average score of 3, but its management has been poor (a score of 2); political interference and moves by the Fujimori administration to curtail such autonomy only worsened the situation as suggested by the World Bank in its description of the Judiciary. The survey by the Instituto Apoyo of Peruvian companies clearly shows the common perception that the current state of management of the Judiciary is seriously damaging the economy. The good intentions of the new Toledo government are likely to improve this rating as and when political and judicial reforms are introduced.

Peru's financial sector is relatively well regulated and supervised and its crises have been managed effectively, which justifies its high overall score of 4. However, we have assigned a 3 to its management, since the formal banking sector has failed to reach the real economy, composed of over a million micro and small enterprises. Nevertheless, the authorities have enabled the formalization of NGOs undertaking micro lending through the passing of the 1997 Banking Law and as a result micro lending activities are among the most successful in Peruvian banking today, acting as a magnet to the formal sector to downscale.

Regarding Corporate Governance, the country has only recently undertaken moves to improve the viability of public investment and should start to see positive results in the medium to long term. However, unless all the multilateral and bilateral donors ensure that they also control and monitor investment projects after disbursement, the overall efficiency of aid is unlikely to be ensured. A low score of 2 has therefore been assigned.

Finally, with respect to Trade and Competition and in particular Customs, Peru merits a high score of 4, due to the successful reform of its customs management which has had a positive impact both on the government's revenues and on trade flows.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[10]					
		1	**2**	**3**	**4**	**5**	**6**
Political System	Rules			X			
	Structure			X			
	Management[11]		X				
	Combined Rating			**X**			
Legal Framework	Rules			X			
	Structure		X				
	Management		X				
	Combined Rating		**X**				
Financial System	Rules				X		
	Structure				X		
	Management			X			
	Combined Rating				**X**		
Corporate Governance	Rules			X			
	Structure			X			
	Management		X				
	Combined Rating			**X**			
Trade & Competition	Rules				X		
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Overall Rating				**X 3.1**			

10 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good

11 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Legal Framework	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Financial System	Objective Setting & Accountability				X		
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures			X			
	Costs / Waste			X			
	Corruption				X		
	Combined Score			**X**			
Corporate Governance	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Trade & Competition	Objective Setting & Accountability				X		
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures				X		
	Costs / Waste				X		
	Corruption				X		
	Combined Score				**X**		

WORLD BANK & IADB MAIN ACTIVITIES IN PERU

Date	World Bank activities Project	Sector	Value US$ million	Lending Instrument	Implementing Agency
2001	Programmatic Social Reform Loan Project	Social Protection	IBRD 100	Programmatic Structural Adjustment Loan	Ministry of Economy and Finance
2001	Second Rural Roads Project	Transportation	IBRD 50	Sector Investment and Maintenance Loan	Ministry of Transportation & Communications (MTC) - PERT-PCR
2001	Biodiversity Conservation Project	Environment	0.77	Grant	IIAP
2001	Indigenous Management of Prot. Areas	Environment	10	Grant	INRENA
2000	Indigenous and Afro-Peruvian Peoples Development Project	Social Protection	IBRD 5	Learning and Innovation Loan	PROMUDEH
1999	Health Reform Program	Health,Nutrition & Population	IBRD 80	Adaptable Program Loan	Ministry of Health
1999	Agricultural Research and Extension Project	Agriculture		Adaptable Program Loan	Ministry of Agriculture
1999	Participatory Conservation Planning in Vilcabamba Project	Environment	0	n/a	Conservación Internacional
1999	Collaborative Management for Conservation and Sustainable Use in the Noroeste Biosphere Reserve Project	Environment	1	n/a	Pronaturaleza
1999	Financial Sector Adjustment Loan Project (02)	Finance	IBRD 300	Sector Adjustment Loan	n/a
1999	Office of the Ombudsman Project	Public Sector Management	0	n/a	Omsbudsman office
1998	Urban Property Rights Project	Public Sector Management	IBRD 38	Technical Assistance Loan	COFOPRI (formalization commission) / RPU (urban registry)
1997	Judicial Reform Project	Public Sector Management	IBRD 22.5	Specific Investment Loan	judiciary, judicial council, judicial academy, ombudsman
1997	National Institute of Statistics and Information Project	Public Sector Management	0	n/a	INEI
1997	El Niño Emergency Assistance Project	Transportation	IBRD 150	Emergency Recovery Loan	sectoral ministers, regional and municipal authorities
1997	Debt and Debt Service Reduction Loan Project	Finance	IBRD 183	Debt and Debt Service Reduction Loan	Ministry of Economy & Finance
1997	Pension Reform Adjustment Loan Project	Social Protection	IBRD 184	Structural Adjustment Loan	Ministry of Finance
1997	Sierra-Natural Resources Management and Poverty Alleviation Project	Agriculture	IBRD 51	Specific Investment Loan	PRONAMACHCS
1996	Irrigation Subsector Project	Agriculture	IBRD 85	Specific Investment Loan	Min. of Agriculture
1996	Second Social Development & Compensation Fund Project	Social Protection	IBRD 96	Specific Investment Loan	FONCODES
1995	Rural Road Rehabilitation and Maintenance Project	Transportation	IBRD 90	Sector Investment and Maintenance Loan	Min. of Transport
1995	Conservation Units Project	Agriculture	5	Grant	PROFONANPE
1994	Primary Education Quality Project	Education	IBRD 146.4	Specific Investment Loan	Ministry of Education & INFES

1994	Lima Water Rehabilitation and Management Project's	Water Supply & Sanitation	IBRD 150	Specific Investment Loan	SEDAPAL
1994	Electricity Privatisation Adjustment Loan	Electric Power & Other Energy	IBRD 150	Sector Investment & Maintenance Loan	Min.of Energy
1994	Institutional Strengthening of the Recipient's Ministry of Economy and Finance (MEF)	Public Sector Management	0	n/a	n/a
1994	Transport Sector Rehabilitation Projects	Transportation	IBRD 150	Sector Investment & Maintenance Loan	Ministry of Transport
1994	Basic Health and Nutrition Project	Health, Nutrition & Population	IBRD 34	Specific Investment Loan	Governme t of Peru
1992	Trade Policy Reform Loan Project	Economic Policy	IBRD 300	Sector Adjustment Loan	Ministry of Econ/Fin
1993	Social Development and Compensation Fund Project	Social Protection	IBRD 100	Sector Investment & Maintenance Loan	FONCODES
1993	Energy and Mining Technical Assistance Project	Oil & Gas	IBRD 11.8	Technical Assistance Loan	Min.Mines/Energy
1993	Privatisation Adjustment Loan	Mining	IBRD 250	Sector Adjustment Loan	COPRI
1992	SAL	Economic Policy	IBRD 150	Structural Adjustment Loan	Min of Economy
1992	Privatisation Technical Assistance Project	Private Sector Development	IBRD 30	Technical Assistance Loan	COPRI
1992	Financial Sector Adjustmen Loan Project	Finance	IBRD 400	Sector Adjustment Loan	Ministry of Econ/Fin
1992	Structural Adjustment Loan Project	Economic Policy	IBRD 300	Structural Adjustment Loan	Min of Economy

WORLD BANK & IADB MAIN ACTIVITIES IN PERU

Date	IADB Main activities Project	Sector	Value US$ million	Lending Instrument	Implementing Agency
2001	Land Titling and Registration Program	Agriculture	23.4	Loan	Ministry of Agriculture
2001	Public Transportation System in Arequipa	Transportation	1	Loan	Municipal Government of Arequipa
2001	23 June, 2001 Earthquake Emergency Relief	Finance	20	Loan	Ministry of Economy and Finance
2001	National Rural Transportation Infrastructure	Transportation	50	Loan	Ministry of Transport and Communications
2001	Transparency and Reform of Fiscal, Social and Judicial Policy	Public sector	250	Loan	Ministry of Economy and Finance
2000	Distance Learning System for Technology Education	Education	1.7	Grant	Insituto Tecnológico Superior
2000	Redesur Transmission Project*	Electricity	53	Loan	Red Electrica de España, Cobra Peru, BSCH,
2000	Improve the Quality of Secondary Education	Education	120	Loan	Ministry of Education
2000	Sector Program for Public Finance Reform*	Finance	200	Loan	Ministry of Economy and Finance
1999	Reconstruction of Infrastructure Damaged by "El Niño"	Public sector	120	Loan	Ministry of Economy and Finance
1999	Health Sector Development	Health	87 + 50	Loan	Ministry of Health
1998	Road Rehabilitation Program	Transportation	300	Loan	Ministry of Transport and Communications
1998	National Program to Assist Children Under Three	Social Development	46	Loan	Ministry of Advancement of Women and Human Development
1998	Multi-Sector Credit program Stage II	Various	200	Loan	Private Sector
1998	Global Credit Program to Microenterprises II	Finance	0.03	Loan	COFIDE
1998	Integrated Financial Management System for Public Sector	Public sector	1.5	Loan	Ministry of Economy and Finance
1997	EnerSur Power Project	Power	60	A Loan	Southern Peru Limited (SPL)
1997	Improving Access to the Justice System	Planning and Reform	20	Loan	Minsterio de Justicia
1997	El Niño Emergency Program	Environment	150	Loan	Ministry of Economy and Finance
1997	System for the National Customs Administration	Public sector	0.75	Loan	Ministry of Economy and Finance, via the Superintendencia Nacional de Aduanas – ADUANAS
1997	Agricultural Health Development Program	Agriculture	45	Loan	Minister of Agriculture
1996	Aguaytía Energy del Perú, S. R. Ltda.*	Power	60	Loan	Aguaytía Energy del Peru S. R. Ltda. (Aguaytía or the Project Company_)
1996	Program for Modernization of the Public Sector	Planning and Reform	58	Loan	Presidencia del Consejo de Ministros (PCM)
1996	Debt and Debt Service Reduction Program	Finance	235	Loan	Ministry of Economy and Finance

1995	Global Microenterprise Credit Program	Finance	25	Loan	Corporación Financiera de Desarrollo SA (COFIDE) Superintendencia de Banca y Seguros (SBS)
1995	Peruvian Education Improv. Program	Education	100	Loan	Ministerio de Educación
1995	Land Titling and Registration Project	Agriculture	21	Loan	Ministerio de Agricultura
1995	Program to Improve the Public Investment Programming Mechanism	Finance	4	Loan	Ministry of Economy and Finance
1995	Rural Roads Rehabilitation and Maintenance Project	Transportation	90	Loan	Minist de Transporte, Comunicaciones, Vivienda y Construcción
1995	Strengthening of Environmental Institutions	Environment	1.8	Loan	Consejo Nacional del Ambiente (CONAM)
1994	Multisector Credit Program	Multisectoral	100	Loan	Corporación Financiera de Desarrollo (COFIDE)
1994	Program to Strengthen the Basic Sanitation Sector	Health	140	Loan	Ministerio de la Oficina de la Presidencia (MOP)
1994	Customs Modernization*	Public sector	1.5	Loan	Superintendencia Nacional de Aduanas (ADUANAS)
1994	Institutional Strengthening of Tax Administration (SUNAT), II*	Planning & Reform	2.2	Loan	Superintendencia Nacional de Administración Tributaria (SUNAT)
1994	Social Stabilization*	Social Development	1.4	Loan	National Compensation and Social Development Fund
1993	Electric Power Transmission and Support for Restructuring of the Electricity Subsector*	Power	45	Loan	Min. of Energy & Mines
1993	Strengthening of Health Services*	Health	68	Loan	Ministry of Health
1993	Assistance for the Basic Sanitation Sector*	Health	2,5	Loan	Ministry of the Office of the President
1993	Social Development Program to Assist Low-income Groups*	Education	6.3	Loan	Ministry of Education National Family Welfare Institute (INABIF)

ANALYSIS OF PERUVIAN FINANCIAL SECTOR

1-Entry		Peru
1.1 Licensing authority		The Superintendent of Banks
1.2 Number of banks		19
1.3 Minimum capital entry requirement		S. 18
1.4 Is information on source of funds for capital required?		Yes
1.5 Are the sources of funds to be used as capital verified by authorities?		Yes
1.5.1 Are law enforcement authorities consulted?		Yes
1.6 Can assets other than cash/govt. securities be used to increase capital?		Yes
1.7 Can borrowed funds be used?		Yes
1.8 Legal submissions required for banking license:	1.8.1 Draft by-laws	Yes
	1.8.2 Intended organization chart	Yes
	1.8.3 First 3-year financial projections	Yes
	1.8.4 Financial information on shareholders	Yes
	1.8.5 Background/ experience of future directors	Yes
	1.8.6 Background/ experience of future managers	Yes
	1.8.7 Sources of funds in capitalization of new bank	Yes
	1.8.8 Intended market differentiation of new bank	Yes
1.9 Number of domestic applications for banking licenses		1
1.9.1 Number denied		0
1.10 Number of foreign applications for banking licenses		1
1.10.1 Number denied		0
1.11 Basis for denial of applications	1.11.1 Capital amount/quality	No
	1.11.2 Banking skills	No
	1.11.3 Reputation	No
	1.11.4 Incomplete application	No
2-Ownership		**Peru**
2.1 Is there a maximum percentage of capital that can be owned by single owner?		No
2.1.1 If yes, what is it?		
2.2 Can related parties own capital in a bank?		Yes
2.2.1 If yes, what is the maximum percentage?		None
2.3 Regulatory restrictiveness of ownership by nonfinancial firms of banks		Permitted
2.4 Fraction of capital in 10 largest banks owned by conglomerates		81%
2.5 Can non-bank financial firms own shares in banks?		Yes
2.5.1 What are the limits?		None
2.6 What is the 5-bank concentration ratio (%)?		81.2

3-Capital		Peru
3.1 Minimum capital-asset ratio requirement (%)		9.1
3.1.1 Is it risk-weighted in line with Basle guidelines?		Yes
3.2 Does the ratio vary with a bank's credit risk?		No
3.3 Does the ratio vary with market risk?		No
3.4 Actual risk-adjusted capital ratio (%)		12.66
3.5 Is subordinated debt allowable (required) as part of capital?		Yes
3.6 What fraction of revaluation gains is allowed as part of capital?		Gains are only allowed as part of reorganization. No specific percentage.
3.7 Percentage of banking system's assets in banks that are 50% or more government owned		2.5
3.8 Percentage of banking system's assets in banks that are 50% or more foreign owned		40.4
3.9 Before minimum capital adequacy is determined, which items are deducted from capital	3.9.1 Market value of loan losses	Yes
	3.9.2 Unrealised securities losses	Yes
	3.9.3 Unrealised foreign exchange losses	Yes
4-Capital		**Peru**
4.1 Securities		Permitted
4.2 Insurance		Permitted
4.3 Real estate		Permitted
4.4 Regulatory restrictiveness of bank ownership of non-financial firms		Permitted
5 & 6-Audit, management, org		**Peru**
5.1 Is an external audit compulsory?		Yes
5.2 Are there specific requirements for the extent of audit ?		Yes
5.3 Are auditors licensed or certified?		Yes
5.4 Is auditor's report given to supervisory agency?		Yes
5.5 Can supervisors meet external auditors to discuss report without bank approval?		Yes
5.6 Are auditors legally required to report misconduct by managers/directors to supervisory agency?		Yes
5.7 Can legal action against external auditors be taken by supervisor for negligence?		Yes
5.8 Has legal action been taken against an auditor in last 5 years?		No
6.1 Can supervisors force banks to change internal organizational structure?		Yes
6.2 Has this power been utilized in last 5 years?		No
7-Liquidity		**Peru**
7.1 Are there guidelines for asset diversification?		Yes
7.2 Are banks prohibited from making loans abroad?		No
7.3 Minimum liquidity requirement (%)		7% of liabilities in local currency; the requirement for forex deposits is determined by the ratio of the 7% of the forex over total deposits, and those banks beginning operations on August 31, 1999, any forex deposits beyond this is subject to 20% min. requirement.

7.4 What interest is paid on reserves?		Local currency requirement is not remunerated; Forex held more than 7% receives LIBOR-1/8 of 1%
Minimum reserve requirement (%)		
How is reserve requirement remunerated		
7.5 What assets satisfy liquidity or reserve requirements?		Cash, deposits at the Central Bank
8-Depositor		**Peru**
8.1 Is there an explicit deposit insurance scheme?		Yes
8.1.1 Is it funded by the government, banks or both?		Banks
8.1.2 Ratio of accumulated funds to total bank assets		0.0047
8.1.3 Insurance limit per account		0
8.1.4 Is there a limit per person?		Yes
8.1.4.1 Amount of limit		Soles 66359
8.1.5 Does deposit insurance authority make the decision to intervene a bank?		No
8.1.6 If no, who does?		La Superintendencia de Bancos y Seguros
8.1.7 If yes, does the deposit insurance authority have the legal power to intervene/takeover a troubled (not insolvent) bank?		
8.2 As a share of total assets, value of denominated debt liabilities not covered by explicit/implicit savings protection scheme?		0.637
8.3 Number of banks merged/closed (as part of failure resolution) in last 5 years		3
8.4 Were depositors wholly compensated the last time a bank failed?		Yes
8.4.1 Average time to pay depositors in full		1
8.4.2 Longest that depositors waited in last 5 years		6 months
8.5 Were any deposits that were not covered at the time of failure compensated when bank failed?		No
8.6 Can deposit insurance agency take legal action against bank directors/officials?		Yes
8.7 Has the deposit insurance agency ever taken any legal action against bank directors/officials?		Yes
9-provisioning		**Peru**
9.1 Is there a formal definition of "non-performing loan"?		Yes
9.1.1 If yes, what is it? capacity of the debtor, which is observed from qualitative factors and quantitative factors, supplementary guarantees, days of delay etc.		Basically the payment
9.2 Classification of loans in arrears:	9.2.1 Substandard	61 to 120 (9 to 30 for micro credit)
	9.2.2 Doubtful	121 to 365 (61 to 120 days for micro credit)
	9.2.3 Loss	365+ (120+ days for micro credit)
9.3 Minimum required provisioning of loans as they become:	9.3.1 substandard	group 1 (potential problem loans): 5 (if without guarantees); group 2: 25 (if without guarantee)
	9.3.2 doubtful	60 (if without guarantee)
	9.3.3 loss	100 (if without guarantee)

9.4 Other classification systems		100 (if without guarantee)
9.5 Ratio of non-performing loans to total assets (%)		0.1814 (without potential problem loan portfolio); 0.3363 (with potential problem loan portfolio)
9.6 If one loan is non-performing, are other loans of a multiple-loan customer classified as non-performing?		Yes
10-disclosure		**Peru**
10.1 Does income statement contain accrued but unpaid interest/principal while loan is performing?		Yes
10.1.1 Does income statement contain accrued but unpaid interest/principal while loan is non-performing?		No
10.2 Number of days in arrears after which interest income cease to accrue		Depends on the type of credit: Commercial: 15 days for all loans, 30 days for micro-finance loans; Consumer: 30 days for individual loan and 90 days for all loans
10.3 Are consolidated accounts covering bank and any non-bank financial subsidiaries required?		Yes
10.4 Are off-balance sheet items disclosed to supervisors?		Yes
10.4.1 Are off-balance sheet items disclosed to public?		Yes
10.5 Must banks disclose risk management procedures to public?		No
10.6 Are directors legally liable for erroneous/misleading information?		Yes
10.6.1 Have penalties been enforced?		Yes
10.7 Do regulations require credit ratings for commercial banks?		Yes
10.6.1 Have penalties been enforced?		Yes
10.7 Do regulations require credit ratings for commercial banks?		Yes
10.7.1 What percentage of top ten banks is rated by international credit rating agencies?		50
10.7.2 What percentage of the top ten banks are rated by domestic credit rating agencies?		
10.7.3 Which bank activities are rated?	10.7.3.1 bonds	Yes
	10.7.3.2 commercial paper	Yes
	10.7.3.3 other	Yes
11-Discipline		**Peru**
11.1 Are there any mechanisms of cease-desist type orders whose infraction leads to automatic imposition of civil & penal sanctions banks directors & managers?		Yes
11.2 Can the supervisory agency order directors/ management to constitute provisions to cover actual/potential losses?		Yes
11.3 Can the supervisory agency suspend director's decision to distribute:	11.3.1 dividends	Yes
	11.3.2 bonuses	No
	11.3.3 management fees	No
11.4 Any such actions taken in last 5 years?		Yes
11.5 Which laws address bank insolvency?		Ley General del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros -Ley N° 26702, modificada mediante las Leyes N° 27008 y N° 27102

11.6 Can the supervisory agency supersede bank shareholder rights and declare bank insolvent?		Yes
11.7 Does banking law allow supervisory agency to suspend some or all ownership right of a problem bank?		Yes
11.8 Does the law establish pre-determined levels of solvency deterioration which forces automatic actions such as intervention?		Yes
11.9 Regarding bank restructuring & reorganization, can supervisory agency or any other govt. agency do the following:	11.9.1 supersede shareholder rights	Yes
	11.9.2 remove and replace management	Yes
	11.9.3 remove and replace directors	Yes
	11.9.4 forbear certain prudential regulations	Yes
	11.9.5 insure liabilities beyond any explicit deposit insurance scheme	No
11.10 Number of banks closed in last 5 years		3
11.10.1 Percentage of total bank assets accounted for by these banks		0.026
12-Supervision		**Peru**
12.1 Bank Supervision Authority		The Superintendencia de Banca y Seguros
12.1.1 Is there more than one supervisory body?		No
12.2 To whom are supervisors accountable?		To none according to the Constitution
12.2.1 How is head of supervisory agency/other directors appointed?		Appointed by the President and approved by the Congress
12.2.2 How is head of supervisory agency/other directors removed		By the Congress or the President upon violation of any of the specified laws
12.3 Any important differences between expectations from supervisory agency and what is mandated by law?		None
12.4 Total number of professional bank supervisors		89
12.4.1 Number of professional bank supervisors per institution		3.6
12.5 Num. of onsite examinations per bank in last 5 years		5 to 8
12.6 Total budget for supervision		Soles 85
12.7 Frequency of onsite inspections conducted in large & medium size banks (annually=1; every two years =2)		1
12.8 Average tenure of a supervisor (years)		12 to 15
12.9 Frequency of supervisors employed by banking industry subsequent to retirement (never=0, rarely=1, occasionally=2; frequently=3)		3
12.10 Must infraction of any prudential regulation found by a supervisor be reported?		Yes
12.11 Any mandatory actions in these cases?		Yes
12.12 Who authorizes exceptions to such actions?		No exceptions allowed
12.13 Number of exceptions granted last year		0
12.14 Are supervisors legally liable for their actions?		Yes

COUNTRY REPORT - POLAND

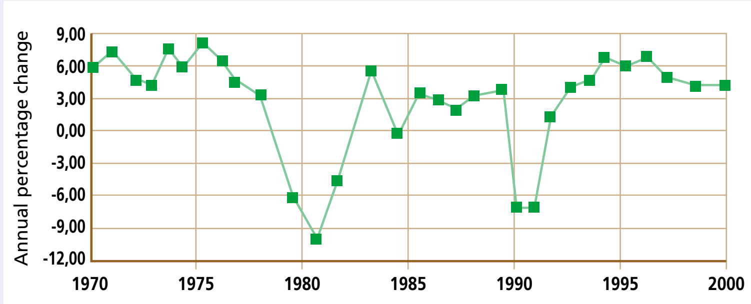
THE EU « MAGNET » AS AN ENGINE FOR WEALTH CREATION

1. DEVELOPMENT PERFORMANCE

After an initial contraction of the economy following its transition to a market economy in 1990, the country has seen a remarkable period of unbroken growth and is considered one of the most advanced transition countries in Central and Eastern Europe poised for EU Accession in 2004. Consecutive governments have introduced a number of economic, social and institutional reforms, which have driven the growth of the economy (70% of GDP is now generated by the private sector), but major challenges remain if the country is to reach its development potential. While Poland has achieved "high human development" according to the UNDP, it still only ranks 38 in the Human Development Index with a GDP per capita of US$8,450 (PPP, 1999).

REAL GDP GROWTH IN POLAND

Exhibit: 1



Source: Compiled From World Economic Outlook Database: IMF

CENTRAL GOVERNMENT FISCAL BALANCE (AS PERCENTAGE OF GDP)

Exhibit: 2

Central Government	1984	1989	1992	1995	1997	1998	1999	2000
Deficit (-)/ surplus	-4.7	-7.4	-4.9	-1.9	-1.3	-1.0	-0.8	-2.2

Source: Compiled from International Financial Statistics: IMF

1.1 Economic Performance

During the 70s, the Polish economy benefited from easy access to borrowing from the West and growth rates averaged almost 6% annually. The accumulation of foreign debt and the country's inability to generate sufficient exports at a time of world economic recession took its toll on the domestic economy and the economic growth rate plummeted to (-)10% in 1981 (see exhibit 1). As the political economy reverted back to centralisation in an attempt to gain control, growth rates averaged just 2% annually over 1982 to 1989.

At the end of the 80s, the economy was one of the first to leave the Soviet bloc[12]. In keeping with the growth experience of the other transition economies, there was a sharp fall in economic growth – real GDP fell by 7.2% in 1990 and by 7% in 1991 – followed by a fast recovery (World Bank, 2002). In addition, hyperinflation occurred also in the transition period (the consumer price index (CPI), reached 585.8% in 1990) but was brought quickly under control by 1994.[13]

Economic growth from 1995 to 1999 was the fastest in Central Europe, driven by a rapid expansion of the new private sector (Balcerowicz, 2000). Real GDP growth averaged 5% annually over the period 1992 to 1997, decelerating by an average of 4.3% to 2000. The more modest growth rates from 1998 reflect the fallout from the Russian crisis and the slowdown in EU demand (IMF, 2000) – both of which adversely affected demand for exports. The loss of competitiveness and the lagged effects of a counter-cyclical monetary tightening in 1997 contributed to a further deceleration in real GDP growth of 4.1% in 1999 from 4.8% the previous year. These factors plus a weakening in domestic demand due to increased interest rates and rising unemployment kept real GDP growth at 4.1% in 2000 (IMF, 2001).

Progress in reducing inflation has been made difficult by the disagreements between the finance ministry and the central bank in the mid-90s. The latter blamed the government for 'structural' inflation arising from anti-competitive policy measures such as import protection, while the former blamed the central bank of losing control of monetary growth by failing to sterilise foreign-exchange inflows (EIU, 2001). Appreciation of the Zloty in 1999, coupled with weak international oil and commodity prices and a slowing of real wage growth contributed to a sharp decline in inflation – annual percentage change decelerated to just 7.3%. This good performance was not maintained in 2001, when inflation growth reached 10.1%.

The fiscal situation deteriorated in the late 90s (from a deficit of 1.3% of GDP in 1997 to 2.2% in 2000, as per exhibit 2). The government is required by law to meet its targets for the central budget deficit. The general practice has been to shift expenditure out of the central government deficit and into an extra-budgetary account. Deficits in the extra budgetary account have meant that the general government deficit, which includes the activities of local as well as central government, has been consistently higher.

External debt

External debt reached its highest with the beginning of the transition period in 1990 reaching 83.7% of GDP and has decelerated annually to 1997, accounting for 35% of GDP in 1999 (see exhibit 3). The declining ratio has been helped by agreements reached with the official creditors in the Paris Club from 1991 and with private creditors in the London Club from 1994. These

12 On January 1, 1990, the first post communist Polish government introduced an unprecedented economic reform plan known as the Economic Transformation Program (Balcerowicz, 2000).

13 Prior to the 1989 parliamentary election, the government increased government spending by increasing the money stock, with resultant increases in the current account deficit (7.4% of GDP) and inflation (from 60.2% in 1988 to 251.1% in 1989) (Mondschean and Opieia, 1997).

EXTERNAL DEBT (AS PERCENTAGE OF GDP)

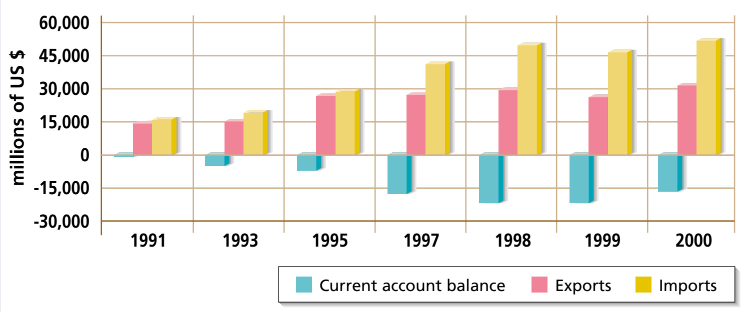
Exhibit: 3

	1981	1985	1990	1995	1999
External debt	26.7	53.3	83.7	34.8	34.9

Source: Compiled from International Financial Statistics: IMF

TRADE IN POLAND

Exhibit: 4



Source: Ministry of Economy, Poland

EXPORT TO IMPORT RATIO IN POLAND, 1991-2000

Exhibit: 5

	1991	1993	1995	1997	1998	1999	2000
Export / Import ratio (%)	96	75	79	61	60	60	65

Source: Ministry of Economy, Poland

TRADE COMPOSITION BY SECTOR (% OF TOTAL)

Exhibit: 6

Exports	1992	2000	Imports	1992	2000
Agriculture	15	8	**Agriculture**	12	6
Mineral	14	6	**Mineral**	19	12
Chemical	10	11	**Chemical**	16	18
Leathers	2	1	**Leathers**	2	1
Wood and paper	6	7	**Wood and paper**	4	4
Light industry	8	10	**Light industry**	5	7
Ceramics	3	3	**Ceramics**	2	2
Metallurgical	19	13	**Metallurgical**	5	8
Electromechanical	19	35	**Electromechanical**	34	39
Various	4	8	**Various**	1	2
Total	100	100	**Total**	100	100

Source: Ministry of Economy, Poland

MAIN TRADING PARTNERS - 2000 (US$ MILLION)

Exhibit: 7

	Export	Import
EU countries	**22,144**	**29,950**
Germany	11,043	11,701
Italy	1,999	4,074
France	1,643	3,151
The Netherlands	1,598	1,739
Great Britain	1,418	2,179
Former USSR countries	**2,959**	**5,743**
Russia	862	4,619
CEFTA countries	**2,662**	**3,461**
Czech Republic	1,198	1,562
EFTA countries*	**600**	**1,074**
USA	**995**	**2,154**

Source: Ministry of Economy, Poland

*Includes Switzerland, Norway, Liechtenstein and Iceland

agreements included generous debt forgiveness packages that relieved Poland of much of the debt burden – around 50% (in NPV) of the Paris and London Club debts were written off, with the reduced debts to be repaid to the Paris Club by 2014 and to the London Club by 2024. The main burden of repayment will not occur until 2005-2008, when Poland must ensure that it has a stable export capacity to sustain debt obligations (EIU, 2001). Poland returned to the international capital markets in the mid-90s. In 1995, it raised US$250 million in Eurobonds with further bond issues in 1996 and 1997. Moody's Investors Service became the first major credit rating agency to assign Poland an investment-grade sovereign credit rating and Standard and Poor's raised their sovereign debt rating for Poland to BBB+ in 2000.

1.2 Trade

Before the intensive programme undertaken by Poland in the early 90s, which enabled the country to liberalise and improve its economy, trade in Poland was very limited. As seen in exhibit 4, during the 90s foreign trade turnover increased from US$30 million in 1991 to US$81 million in 2000. This growth has been determined by a triple increase in imports and a more modest double growth in exports.

Compared to Central and Eastern European countries with similar levels of development, Poland's foreign trade in relation to GDP is still considerably low; e.g. in 1997 Poland's share of exports in GDP amounted to 19%, whereas in the Czech Republic it was 47% and in Slovakia 55%[14] .

In the 90s the export to import ratio dropped (from 96% in 1991 to 65% in 2000, see exhibit 5) and consequently with an increase in the current account balance deficit from US$ -619 million in 1991 to US$ -17,289 million in 2000. This deficit was a result of the inability of exports to catch up with the dynamic growth of imports, due to the important growth of investment and supply import. The highest growth of imports was registered in the electromechanical and chemical industry products. In 1999-2000, increased exports of these products contributed to the shrinking of the deficit.

The structure and composition of trade in Poland changed in the 90s (see exhibit 6). The country has a variety of natural resources including coal, copper, zinc, iron, gypsum, lignite and some oil and natural gas reserves. Cars, car parts,

14 See Ministry of Economy, Foreign Trade analysis, www.mg.gov.pl/english/daip_enu/ocena_prognoza/report_98/fr_i.htm
15 Poland investment profile, EBRD

(electromechanical sector), wood and chemical products and machinery and equipment (light industry) have become important export products, with the re-export of processed imports (especially in the chemical and electromechanical sector) playing a large role in some of the above-mentioned categories. The share of food industry has dropped over the years. Poland's challenge is to move to higher value-added industrial and service branches while also developing its agricultural export potential[15].

As shown in exhibit 7, Poland trades primarily with the EU (67% of total exports and 58% of total imports in 2000). Among the EU countries the most important partner is Germany (35%), followed by Italy (6%) and France (6%).

1.3 Development aid

Official aid flows

Net public flows as measured by net ODF (constant 1999 US$), has fluctuated over the last thirty years from a high of US$4.6 billion in 1990, to a low of US$929.2 million in 1997 (as shown in exhibit 8). Poland rejoined the World Bank in 1986 after a hiatus of 38 years and the Bank's first loan was made in 1990. Net ODF has declined as a proportion of GDP from 1995 when it accounted for 3.4% of GDP to less than 1% in 2000. Net public flows per capita reached a high of US$92.47 in 1995, declining to US$24.04 in 1997. Net public flows per capita in 2000 was worth US$44.35.

The data in exhibit 9 shows that net flows of bilateral aid have provided the bulk of total public flows for the majority of the last decade, accounting for over 91% of total public flows in 1990. Since 1997, multilateral flows of public aid have outpaced bilateral flows, accounting for over 72% of total public flows in 2000. Official development assistance continues to be the dominant source of net public flows outperforming other official flows except at the beginning of the period and accounting for 91.4% of total public flows in 2000. Other official flows have become increasingly important as a source of total multilateral flows from 1996.

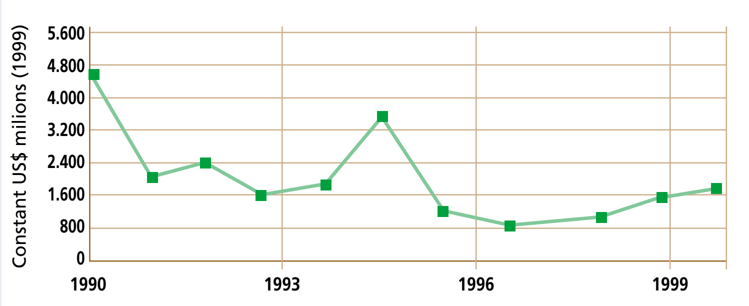
The EU member countries represent the largest donors of ODA to Poland (see exhibit 10), by contributing roughly three-quarters of a billion dollars annually, while the US has contributed a yearly average of US$300 million and Australia, Canada and Switzerland combined have contributed on average US$100 million per year. Japan accounts for approximately US$58 million on average.

Private flows

As clearly shown in exhibit 11, net private capital flows escalated over the 90s. During 1981 to 1990, net private capital flows were worth US$416 million in real (US$ 1999) terms per annum on average, increasing to US$5.6 billion on average over the remainder of the period to 1999. Net private capital flows increased from 0.1% of GDP in 1990 to 6.7% in 1999. Foreign direct investment (FDI) has been the main driver behind the significant increase in net private capital

NET PUBLIC FLOWS EVOLUTION (ODF) IN POLAND

Exhibit: 8



Source: Compiled From OECD DAC Online Database

NET OFFICIAL FINANCING MULTILATERAL AND BILATERAL FLOWS (% OF TOTAL)

Exhibit: 9

		1990	1993	1994	1995	1996	1998	1999	2000
Net ODF		100	100	100	100	100	100	100	100
	ODA	33	68	102	88	86	86	85	91
	OOF	67	32	-2	12	14	14	15	9
Bilateral ODF		91	60	39	81	53	48	33	29
	ODA	28	97	227	98	122	96	126	119
	OOF	72	3	-127	2	-22	4	-26	-19
Multilateral ODF			9	37	61	19	47	54	54
	ODA	85	19	23	41	45	78	80	77
	OOF	15	81	77	59	55	22	20	23

Source: Compiled From OECD DAC Online Database

OFFICIAL DEVELOPMENT ASSISTANCE: DONOR DISBURSEMENTS (% TOTAL, 1999)

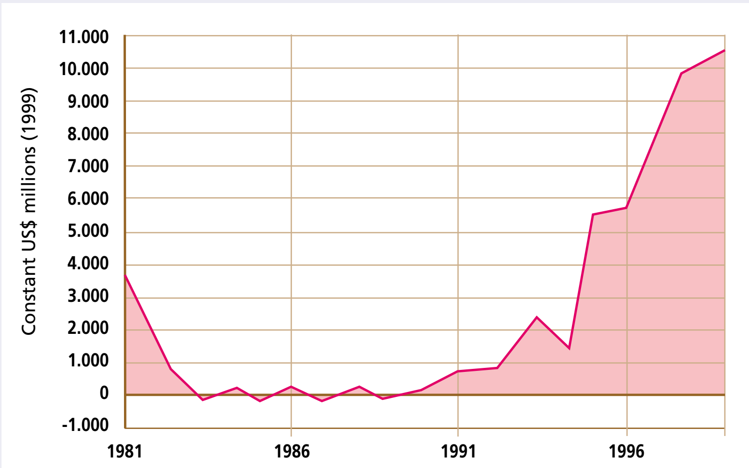
Exhibit: 10

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
EU members	52.31	28.65	66.41	84.00	35.54	91.42	67.14	75.18	66.92	72.29	75.77
Japan	17.25	0.14	7.28	10.15	5.20	2.92	10.87	0.84	0.61	-0.45	-0.54
US	29.06	67.52	9.90	2.62	58.60	0.15	4.46	4.48	6.62	6.51	5.29
Other	1.38	3.69	16.41	3.23	0.66	5.51	17.53	19.51	25.85	21.65	19.49
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Compiled From OECD DAC Online Database

NET PRIVATE FLOWS EVOLUTION IN POLAND

Exhibit: 11



Source: Compiled From World Bank Development Indicators

AID AS A PERCENTAGE OF GDP

Exhibit: 12

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Aid as % of GDP	2.6	3.1	1.8	1.9	3.4	0.9	0.7	0.6	0.9	1.0

Source: OECD DAC online Database

RATIO OF PRIVATE VERSUS OFFICIAL FLOWS

Exhibit: 13

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Private/Official	0.02	0.3	0.3	1.6	0.7	1.5	4.7	8.1	9.9	7.5

Source: OECD DAC online Database

flows over the 90s, at over US$3 billion on average per annum from 1990 to 1999. Furthermore, bank and trade-related lending and portfolio investment flows (bonds and equities) have also contributed to the large increase in net private capital flows.

Role of aid and its effectiveness

Official aid played an important role in the early stage of the transition period, helping Poland to initiate economic reforms and set up the infrastructure to attract private investment. In 1992, aid reached 3.1% of GDP (see exhibit 12). During this time the World Bank provided extensive financial and technical support to the government's economic transformation efforts. The Bank's first loan was made in 1990. Cumulative commitments of over US$5.4 billion (US$4.1 billion net of cancellations) have financed 37 operations (see appendix 1).

In general, the IFIs played a major role in promoting reform in all sectors. In particular, all (including EU's PHARE) have supported Poland in its efforts to meet the EU accession criteria (the "aquis communitaire").

Since the mid-90s private flows have become the main driver of growth in Poland, in particular as mentioned above FDI. Private flows have accounted more than 5 times official flows since 1996 (refer to exhibit 13).

Since Poland's effective implementation of economic reforms, the World Bank and other multilateral institutions provide mainly technical assistance; policy advice and support to the private sector within the overall context of helping Poland meet EU accession objectives.

Aid and NGOs in Poland

Although among the most solid in Central and Eastern Europe, NGOs in Poland continue to suffer from weak contact with the government and have no legal representation. It is important to mention that NGOs in Poland are very active in providing services to the tertiary sector.

Poland has close to 30,000 registered NGOs, many of which are small, under-funded, or inactive. These include professional associations; social service, environment, religious, youth, charity organisations, and those dealing with issues related to women, which are very active. According to available data, the largest women's organisation of a social and vocational character, with about 1 million members, is the Rural Housekeepers Association and Polish Women's League. The Information Centre for Women's Organisations (OSKA), which is located in Warsaw, integrates various initiatives regarding women's issues. The Centre for Women's Rights is also very active.

Polish NGOs' activities vary widely, from education, health care, social welfare, culture and human rights, to local economic development and the environment. It is estimated that the Tertiary sector in Poland accounts for approximately 1.1% of total employment. The most popular types of organisations are groups active in education (5.5 %) and church organisations (3.9%)[16].

Funding

Many Polish NGOs remain financially dependent on international donor support for a substantial part of their budgets. A good example is the U.S. Agency for International Development's (USAID) DemNet project, which has awarded grants and worked with some 67 NGOs. In the last few years, several organisations have actively provided services to the Tertiary sector. These include the SPLOT-network, which combines ten regional centres and the KLON-JAWOR database; the Civil Society Development Foundation; and Partners Polska. These organisations provide the smaller, local NGOs with training and access to information. These NGOs are typically weak given their reliance on volunteers who seldom have time to participate in training sessions.

Currently a growing number of Polish NGOs are developing other sources of revenue, in particular by forming partnerships with the local government. Community foundations are taking root in a number of communities, but philanthropy is still in the early stages. The Warsaw-based *Academy for the development of Philanthropy* is a foundation that supports community foundations throughout Poland.

The financial situation of the Tertiary sector may deteriorate, though, as a result of limitations of Western aid programs such as United Nations Development Programme and the European Union's PHARE program. However, the Polish-American Freedom Foundation was launched in 2000 and, in a few years' time its capital, mostly from the Polish-American Entrepreneurship Fund, will reach US$180 million. Likewise, a consortium of private grant-making institutions has set up the Trust for Civil Society in Central and Eastern Europe to promote the development of civil society in the region. The new organisation, whose members include the Charles Stewart Mott Foundation, the Ford Foundation, the German Marshall Fund of the United States, the Open Society Institute and the Rockefeller Brothers Fund, aims to create a ten-year US$75 million fund. This will create the basis for the existence of think tanks and large networks and will make training, publishing, and other educational activities possible.

Organisation capacity

The NGO sector in Poland is beginning to evolve from organisations based upon their pioneer founders into more institutional leadership structures that can sustain their organisations in the longer term.

Policy making involvement

As Article 61 of the constitution gives citizens the right to petition administrative agencies and public institutions. Article 75.1 guarantees citizens the right to lodge complaints with the constitutional court. Lobbying activities are permitted and political endorsements are legal. Freedom of association and assembly include the right to hold public demonstrations. State sector managers, business groups, trade unions, farmers' associations, and some NGOs are active in the political and policy making process through direct meetings with government officials, thus providing government agencies with information and media access.

16 1999, Survey conducted by the Warsaw based Public Opinion research centre (CBOS)

In general, though, as mentioned above the fact that NGOs are still not legally represented accounts for their weak relations with the government. Thus, NGOs are unable to present the government in advance with any recommendations relating to their needs and concerns. Instead, they can only react to disadvantageous administrative and legal decisions after these have been adopted by the government. Politicians on their side have been "trained" to consult with NGOs, but do not necessarily do so in practice.

1.4. Poverty reduction

Despite an impressive economic performance over the last decade, poverty, at 18.4% of the population according to the World Bank, is relatively high compared with other advanced transition countries. Poverty reduction is one of Poland's main challenges in the coming years.

Factors determining poverty in Poland are similar to those of other transition countries – the unemployed, large families, families with a single breadwinner and low levels of education (World Bank, 1999). According to another World Bank study (2000) that examined groups at risk of poverty, those most at risk in Poland, were: children, those with primary education only, and those living in rural areas and in the East of the country. The poverty risk index for those unemployed and with an inactive head of household was approximately 2.5. This index was greater than all of the other CSB countries, except for the Czech Republic (6.7), Slovenia (3.5), Croatia (3.1), Estonia (3.5) and Romania (2.6) (World Bank, 2000). Less than 10% of the adult population in Poland has post-secondary education, similar to the Czech Republic and Romania.

The country's impressive growth and development has failed to reach all parts of society, particularly those in rural areas. Poverty is closely linked to the high unemployment rate (over 17% in 2001), particularly in the rural areas. While Warsaw had a 3.2% unemployment rate, the Warminsko-Marzurskie region, for example, had 25.8% unemployment. Job losses stemming from privatisation and declining exports to Russia have been exacerbated in an overly-restrictive labour market[17]. Further risk stems from declining farm incomes as a result of depressed producer prices[18]. The potential impact from post-accession competition from EU producers on rural incomes is a major concern for the government.

Therefore, the Polish government has asked for World Bank assistance in preparing a comprehensive programme to facilitate private investment and in creating new jobs in poor rural areas. The programme is targeted initially towards eight voivodships selected on criteria such as high unemployment rates, low GDP per capita, poor levels of education and over-employment in agriculture. Assistance in 1999 focused on rural infrastructure (roads, telecommunications, water supply, waste water systems), human capital development (upgrading rural education, providing employment services, and strengthening local administration capacity) and private sector development (support for developing entrepreneurship and new businesses, including micro-credit and business incubator schemes). The programme is demand-driven, with local governments responsible for preparing and implementing their own projects from the menu of activities that are supported under the programme.

SOCIAL INDICATORS IN POLAND

Exhibit: 14

	1975	1985	1995	1999
Infant mortality rate (per 1,000 births)	29	22	13.6	9.1
Life expectancy at birth (in years)	71	71	72	73
Primary school enrolment rate (in %)	100.4	101	96.4	n.a.
Secondary school enrolment rate (in %)	71.7	78.2	97.6	n.a.
Adult illiteracy rate (in %)	1.4	0.6	0.3	0.3
Immunization DPT (% children under 12 months)	97	94	96	98

Source: Compiled from World Bank Development Indicators, various

COMPARATIVE PERFORMANCE 2000

Exhibit: 15

	Poland	Europe & Asian countries	Upper middle income countries
Population (million)	38.7	475	647
GNI (Atlas method, US$ billion)	163	956	2,984
GNI per capita (atlas, US$)	4,210	2,010	4,620
Poverty (% population below national poverty line)	n.a.	n.a.	n.a.
Urban population (% of total)	66	67	76
Infant mortality rate (per 1,000)	9	21	28
Life expectancy (years)	73	69	69
Access to improve water source (% of population)	74	90	87
Adult illiteracy rate (% of population)	0	3	10
Gross primary enrolment (% school age population)	96	100	107

Source: World Bank

Social indicators

Exhibit 14 shows the evolution of social indicators in Poland over the last three decades.

Overall Poland has improved its social indicators. For most indicators, Poland has reached an above-average level, particularly in the areas of infant mortality (9.1 ‰ in 1999) and life expectancy (73 years in 1999).

Poland's relative performance compared with similar countries

Exhibit 15 shows Poland's well above average rates for most social indicators when comparing to similar countries. Of particular note again, infant mortality (IMR) and life expectancy have achieved a great progress. By 2000, IMR fell to 9 per 1,000 births and life expectancy reached the level of a developed country, at 73 years. Still, access to improved water still remains behind the average of Europe and Asian countries as well as upper middle-income countries.

2. INSTITUTIONAL INFRASTRUCTURE

2.1 The political system *(Overall rating 3)*

2.1.1 The Rules

The interim constitution adopted in 1992 was replaced by the new constitution in 1997 following a national referendum. The new constitution guarantees free healthcare and education, a minimum wage and a range of other social provisions. It sets a ceiling on public debt (60% of GDP) and declares that the budget deficit should not exceed the limit set by parliament. It beholds the government to combat unemployment and homelessness. It also strengthened the role of the parliament and reduced the powers of the president.

The president is head of state and supreme commander of the armed forces. Once elected, the president may not serve more than two five-year terms.

17 This includes hindrances such as lack of adequate hiring and firing legislation, workplace regulations, excessive payroll taxes and high minimum wages.
18 Due to the loss of markets in Russia and increasing inroads made by subsidized imports from the EU.

The 1997 constitution limits the circumstances in which the president can dissolve the parliament. The president may veto legislation, but this may be overthrown by a three-fifths majority in parliament. The president nominates the prime minister but the candidacy is subject to parliamentary approval.

Parliament must also approve the members of the Council of Ministers (cabinet) selected by the Prime Minister. The two houses of parliament are elected simultaneously for four-year terms. The lower house, the Sejm, has 460 seats and members are elected from multi-member constituencies by proportional representation. The upper house, or the Senate, which has few powers, has 100 seats and members are elected by a first-past-the post system. Political parties need a minimum of 5% of the nation-wide vote and alliances need 8% of the nation-wide vote for parliamentary representation (EIU, 2001).

2.1.2 The Structure

Party politics

The two largest political parties, the Solidarity Electoral Action (AWS) and the Democratic Left Alliance (SLD), can trace their roots back to the Solidarity movement and the communist era respectively. Both parties account for approximately 27-30 % of voter support. The first Solidarity government came to power in 1989. The PZPR – the ruling party from the communist-era was dissolved. The 90s were characterized by a volatile political climate with a succession of short-lived Solidarity governments. Post communist groupings with roots in the old political system curried favour with the electorate by transforming themselves into a Western-style social democratic grouping, the SLD. The SLD came to power in 1993 in a coalition government with the Polish Peasants' Party (PSL), serving its 4-year term, albeit with three changes of prime minister. The AWS formed a governing coalition in 1997. Its coalition government with the Freedom Union (UW)[19] eventually collapsed in June 2000 and AWS continued in a minority government. However, its weak political base, internal squabbling, weak government programs and allegations of corruption paved the way for victory of the SLD in 2001 (EIU, 2001). The SLD has been far more successful in bringing about internal consolidation[20] than the AWS, although its main support base of the low paid and pensioners may prove fragile in a poor economic climate. Some inkling of this became apparent in the most recent elections, when populist parties became even more popular. The Self - Defence (Samoobrona) entered parliament for the first time as the third largest parliamentary grouping. Its campaign is one of 'opposing reforms' and has garnered widespread support from the farming community[21] and urban votes disenchanted with economic conditions since the fall of communism (EIU, 2001).

Government

The administrative reforms initiated in 1999 devolved substantial actions to sub-national governments and increased the amount of public funds disbursed at sub-national level by 2.3% of GDP between 1998 and 1999. However, local government autonomy and accountability for expenditures and revenues remains limited, and a major effort is needed to improve local governments' capacity for service delivery, and to improve their accountability and transparency as a means to reduce corruption.

Poland's civil service is under the constitutional supervision of the Prime Minister, who appoints the Head of Civil Service, assisted by the Office of Civil Service. The Office is composed of five basic structures: the Secretariat of the Head of the Civil Service (including press service and editors of the Civil Service Bulletin), the Office of the Director General, the Department of Recruitment and Selection, the Department of Civil Service Corps Management, and the Department of Training and Development of Civil Service Corps. Besides, the Prime Minister can call on an advisory body, the Civil Service Council, consisting of 16 members (half of them representing the Parliament and half chosen by the Prime Minister himself).

2.1.3 Management

Poland has efficiently established a well-functioning democratic process within all institutions. However, the management and governance of public expenditures and the lack of qualified personnel, among other management inefficiencies, still need to be addressed.

Democratic elections

Poland achieved stability of its institutions guaranteeing democracy and the rule of law. In April 2001, the Sejm adopted new election regulations and an amendment to the Act on Political Parties. Main improvements have been:

- The counting of votes to parliamentary seats is now conducted in line with a modified St. Lague's method rather than the previous d'Hondt system. The new system is also one of proportional representation, but based on a different method of allocating seats to votes. It is considered to give a more accurate reflection of voter preferences and so diminish the over-representation of large parties which characterized the previous system. Elections to the Senate are now conducted on the basis of a majority system.
- The national list has been abolished: consequently, all deputies are elected by voters in their constituencies. This coincides with the redefinition of constituencies within the act to correspond to the changes brought about by the territorial reform of 1999. The law defines 41 Sejm electoral districts, comprising of 7 to 19 seats. Elections to the Senate will be conducted in 40 constituencies with 2 to 4 senators elected in each district.
- The amendment to the Act on Political Parties has also introduced a number of significant changes relating to the conduct of elections. The most important changes are aimed at regulating the issue of party financing with a view to curbing possible corruption[22]. In parallel party financing will be subject to increased scrutiny[23]. Parties will no longer be allowed to conduct public collections and companies will no longer be able to finance political parties through any form whatsoever.
- The most significant development has been the adoption of the law on public information[24], which codifies the freedom of information provisions set out in the constitution. The reporting period also saw the

19 The Freedom Union party had been the principal centre-right party, accounting for 13% of votes at its peak at the 1997 election. Its popularity has declined, precipitated by its decision to go into opposition in the 2001 election and its failure to stand as a candidate in the 2000 presidential election. Internal divisions were brought to the fore when Leszek Balcerowicz stood down as party leader in late 2000. The party split, with the neo-liberal faction joining the newly formed Civic Platform (PO), which won 65 seats in the 2001 election.

20 Originally an alliance of 30 groups, parties and associations led by Poland's renamed and reorganized former communist party, the Social Democracy of the Polish Republic (SdRP). The SLD firmly backs the goal of joining the EU and is committed to macroeconomic stability.

21 Agricultural employment accounts for 27.4% of the workforce (including forestry and fishing) and thus represents a formidable political voice.

22 Under the new regulations, parties will receive substantial public funding, amounting in total to around PLN55-60 million (13.75-15 million) annually. If they obtain at least 3 percent of votes in the next elections parties will be entitled to a budget subsidy. The amount will depend on the number of valid votes cast for the party.

23 Contributions from private persons cannot exceed PLN11,000 (2,750) annually. All payments have to be registered. In addition, parties are now banned from earning income from real estate rental or commercial activity. These provisions mark an important step towards ensuring the transparent working of the political system.

24 The law on public information was signed by the president at the start of October 2001. It sets out a clear definition of the right to public information, based around the entitlement to information which is in the public interest, the entitlement to review official documents and the entitlement to access to the sittings of elected government bodies. As always with such legislation, effectiveness will in large part be determined by the exemptions from the law and its interpretation. With regard to the exemptions, these are largely taken from existing legislation

implementation for the first time of the new Presidential Elections Act. This has resulted in some initial difficulties but demonstrates that the new procedures are a significant advance.

In May 2001 the State Elections Commission (PKW) completed the verification of presidential campaign reports. This was conducted, for the first time, in accordance with new, stricter rules governing campaign financing introduced by an amendment to the Presidential Elections Act adopted by the Sejm in April 2000. The examination proved that all election committees have, in various ways, breached the Act. As a result, the PKW decided to reject the statements of all twenty-one candidates.

Some of the breaches were relatively minor; others were more significant (notably with regard to accepting donations from companies with foreign capital or which were financed from public funds, which did not derive from companies' profits or which came from individuals with unknown or false identities).

Nonetheless, it should be recalled that the new legislation is a significant step in strengthening democratic procedures. Following the 1995 elections only 10 out of 17 candidates submitted election campaign reports, and there was no provision for sanctions for non-compliance with this requirement.

Civil service - Quality of personnel

Despite a well functioning democratic process, Poland suffers from a poor provision of public services. In particular, the small percentage and quality of the civil service within the overall public administration still remains a major concern. By the end of September 2001, the number of civil servants was 831, i.e. some 0.7% of a total 116,000 employees of the central administration. This represents an increase of around 270[25] over last year, and compares to 161 civil servants appointed under the 2000 exercise.

Workers in the civil service at national and regional level fall into a number of categories; "Civil servants" as defined by the 1999 law form the managerial corps, while the most numerous categories at the national level is that of "civil service employees." The most significant change has been the adoption of an ordinance on the remuneration of civil service employees and an ordinance on the determination of official positions requiring professional qualifications, professional grades of civil servants and issues of remuneration and benefits. However, the major point of concern continues to be the number of civil servants (i.e. those who passed the selection procedure) in relation to the total civil service corps.

As was noted in the latest EU Progress report on Poland's accession, the increase in the number of civil servants, despite some acceleration last year compared to the first year of operation of the law, is still too slow to produce an independent, stable and competent civil service in the immediate future. The risk of political instability attached to more senior posts in the public administration has been exacerbated by the expiry at the end of June this year of the transitional period for the provision of the Law on Civil Service. This imposed an obligation to organise open competitions for the top posts in the administration (from directors-general upwards, including the head of the civil service himself). As a consequence, all those who were appointed to their posts without a competition were formally dismissed on 1 July 2001. Pending the completion of the necessary competition, 16 of the 69 director-general level posts are vacant. In the meantime these vacancies are being filled by managerial staff from the department as "acting" directors-general.

The position of the Civil Service Office requires some strengthening, as its key function is the supervision of the civil service. The role and functions of the Office within the governmental structure are perhaps not fully understood or appreciated. It is generally associated with training programmes and recruitment procedures instead of being perceived as the supervisory body and the institution which addresses policy issues, sets the direction for the development of structures and builds the culture of the civil service as such. As a result, some of the Office's proposals for structural change have had a rather weak response from the bodies to which they were directed. While further efforts have been made over the last year to improve the profile, status, standing and rewards of the civil service through both legislation and, notably, information campaigns, the long-standing disincentives to a civil service career remain.

Budgetary discipline and Aid Management

Aid is managed by the Ministry of Finance - jointly by the State Budget Department and the Aid Funds Servicing Dept. Aid and budget management is perceived to be managed inefficiently although in their latest CAS, the World Bank indicates that the Operation Evaluations Dept. of the World Bank has evaluated 24 projects in Poland, of which 19 were satisfactory and 5 unsatisfactory.

The basics of public expenditure control (see Corporate Governance in section 2.4.) and management systems are in place in Poland. However, most observers point to a clear need to improve the impact of public expenditure on the economy. For this to be achieved actions are needed on two fronts; (i) the management and governance of the public expenditures need to be improved and (ii) expenditures need to be reviewed thoroughly for their appropriateness, efficiency and targeting.

The existing 'fragmentation' in the budget management system, notably caused by excessive number of extra-budgetary funds and public sector agencies, needs to be changed. The current system severely limits fungibility of resources and makes it very difficult for the government to comprehensively manage budget flows, control expenditure levels, and thus deficits. The governance of those extra-budgetary funds and public sector agencies which would remain in existence needs to be strengthened, including through more transparent appointment processes and stricter requirements for financial transparency and accountability. In addition, a clear identification and delineation of responsibilities of each ministry and its departments for programme and policies is needed.

The fundamental structural reforms which Poland is completing are nevertheless going in the right direction. However, the magnitude of the changes being put in place in such a short time is putting increased strain on public administration, which does not have sufficient human and financial resources to adequately manage the introduction and implementation of the reforms. Similarly, these constraints on public administration are also beginning to undermine the ability of the state to implement EU rules and regulations and absorb EU and other aid funds effectively.

Within this context, an important emerging issue for Poland is the question of how to upgrade the quality, efficiency and effectiveness of state administration. Such an effort requires actions to inter alia, improve salaries and working conditions (so that the administration can attract, train and keep qualified and experienced personnel), streamline ministerial functions, procedures and the decision making process, and reduce unnecessary controls and regulations.

2.2. Legal Framework
(Overall rating 3)

The Republic of Poland is based on the Montesquieu's separation of powers principle. The legislative power is vested

25 As a result of graduation from the National School of Public Administration (in 2001, 58 alumni were appointed as civil servants) and the conclusion of the annual competition, from which 218 were selected.

in the Parliament consisting of the lower house "Sejm" and the upper house "Senate". The executive power is vested in the President of Poland and the Council of Ministers, and the judicial power is vested in courts and tribunals.

2.2.1 The Rules

Article 173 of the Polish constitution ensures the independence of the courts, and article 178.1 provides for the independence of judges. According to article 180, judges cannot be dismissed against their will, and according to article 181 they enjoy near total (both professional and personal) criminal immunity.

The constitution of 1997 expanded the competency of the constitutional tribunal. Judges are nominated by the National Judicial Council, created in 1989 and appointed by the President. The National Judicial Council consists of the Chief of Justice of the Supreme Court, the Minister of Justice, the Chief Justice of the Superior Administrative Court, 15 justices chosen among the Supreme Court and lower courts and four members chosen by the parliament. Judges are appointed for life and can be reassigned but not dismissed, except by decision of the National Judicial Council.

Important amendments in different areas within the legal framework have been made:

- The introduction, in October 2001, of a law on the Common courts system which transfers competence for "petty" cases – civil claims below PLN5,000 (around 1250) – from the civil criminal chambers to the grodzki chambers (courts of justice).
- The enforcement, in January 2001, of the November 2000 amendment to the law on the national court register. The amendment provides the legal framework for the functioning of the computerised National Court Register. In January 2001, 14 regulations executing this law, issued as ordinances of the Minister of Justice, entered into force .
- The enforcement, in June 2001, of the law on the National Penal Register referred to in the 2000 Regular Report. The law sets forth detailed rules of the organisation, operation, and scope of the National Penal Register. The Register arises out of the transformation of the Central Register of Convicts.
- The adoption, in May 2001, of the legislation amending; (i) the law on land registers and mortgage, (ii) the law on the Civil Procedure Code, (iii) the law on court costs in civil cases and (iv) the law on the notaries.

2.2.2 The Structure

The Supreme Court is the highest central judicial body in the Republic of Poland and thus the highest court of appeal. The main tasks of the Supreme Court are to administer justice in Poland, together with the common, administrative and military courts, to consider cessation as a form of extraordinary appeal and to adopt law interpreting resolutions. In the Supreme Court judges are appointed by the president on the recommendation of the National Council of the Judiciary for an indefinite period.

The common courts in Poland are the courts of appeal, provincial courts ("okr_g") and district courts ("rejon"). They are competent to hear criminal law cases, civil law cases, family and custody law cases, labour law cases and social insurance cases.

The administrative judiciary is part of the High Administrative Court. This court has judicial control of public administration and operates through 10-delegated centres of the same Court. The military courts are the military provincial courts and military unit courts. They have judiciary control within the Polish Army in criminal cases and other cases that were subscribed to them by relevant statutes.

The Constitutional Tribunal is an independent constitutionally recognised state body. Its scope of jurisdiction is: 1) the review of norms, 2) the adjudication of disputes over authority between central, constitutionally recognised bodies, 3) decision making with respect to the conformity of the activity of political parties with the Constitution and 4) the recognition of the temporary incapacity of the President to discharge his/her office. The tribunal is comprised of 15 judges including a President and a vice President. They are nominated by the Sejm (lower house of parliament) for nine-year terms and appointed by the President of the Republic. In 1999, the Constitutional Tribunal issued 52 verdicts, 29 of which stated that certain pieces of legislation did not conform to international agreements or regulations and, therefore, were unconstitutional.

2.2.3 Management

Despite the previously described reforms, the three main problems with the Polish judiciary today are: the backlog of cases, corruption and the bankruptcy law.

Actions to rationalise the court structure and improve its functioning have continued over the last few years and in particular in 2001. As of July 2001, the number of regional courts in operation was thirty-eight. Furthermore, the territorial jurisdiction of common courts has been harmonised with the administrative borders of the new voivodships. This harmonisation is intended to facilitate better co-operation between the judicial administration and other public bodies functioning under the territorial structure which was put in place in 1999.

The legislation amendments adopted in May 2001 (see 2.2.1) were intended to improve the court registration system by accelerating proceedings related to real-estate registration, and to fully introduce the modernised and computerised real-estate register. As a part of this process, staffing levels at the real-estate register departments have been reinforced by increasing the number of *referendarz* to 390, an increase of 100 over the year. There was a slight increase in the number of judges[27] (up to 8,335) and prosecutors (up to 5,313). The 1999 Strategy on computerisation continues to be implemented, although considerable needs still remain. The number of computers within the judiciary was increased to 7,500 by end 2000, most of them situated in the courts rather than in the prosecutor's offices. In parallel, networking at national level is being completed for both the courts and the prosecutor's offices. A specific software package is being developed together with a network for prosecutors dealing with organised crime. Training, notably with regard to European Community law, has steadily increased. Community Law is compulsory in the last six months of training, together with International Law. There are also a number of vocational training courses organised around both general and specific areas of EC Law.

According to Freedom House, Poland's judicial system is still quite inefficient. The considerable delays in deciding cases brought before the courts are the principal problem. In January 2000, for example, the statutory time limit ran out on a case involving the burning of approximately 13,000 former secret police documents in 1989 and 1990[28]. Following inquiries by the press, the Ministry of Justice determined in April 2000 that the statutory time limit for dealing with 713 other cases (most of which are lodged with Warsaw courts) would soon expire. However, the ministry dismissed the situation as "an incidental problem" because these amount to a mere 0.005% of all the cases pending a court decision.

26 The National Court Register is a centralised, fully computerised register of companies, associations, other social and professional organisations, foundations, public health care institutions and insolvent debtors.
27 The increase in the number of judges (+348) has in large part taken place in order to meet the expected increase in cases following the introduction of the code of minor offences.
28 The documents included the files of secret informers and microfilm from the Interior Ministry's third and fourth departments, which used to carry out surveillance of the opposition and churches.

Still these efforts to increase the efficiency of the judiciary system (mentioned above) represent positive steps leading to a reduction of the backlog. At this early stage in their implementation, such measures have helped to stem the tide but have not yet managed to reverse its flow. This holds equally true for the regional disparities in the length of the backlog, with the situation in Warsaw remaining more difficult than for the country as a whole. During 2000, the courts settled almost 10% more cases than in 1999: the total number of cases settled being almost 7.37 million. However, as a result of the increase in cases referred to the Court there was a small increase in the backlog to 1.81 million cases. It should be noted, however, that in some categories of cases, the average duration of the legal procedure has been reduced. This is particularly true for real-estate registration cases, which lasted an average of 3.3 months in 2000 compared to 3.7 in 1999, and for civil cases in district courts (4.3 months in 2000, 4.7 months in 1999) and in regional courts (5.6 months in 2000, 5.9 months in 1999). Initial figures indicate that this trend has continued into the first half of 2001.

Concerns about corruption within the system persist. To some extent there is a divergence between perception and reality. Reports suggest that some 20 cases were reported in 2000, while the Central Bureau of Investigation indicates that three cases were investigated last year. Efforts have been made by the government to increase the remuneration of court employees, judges and administrative staff so as to counteract one factor often linked to corruption. Concerns about corruption in the judiciary have led to a broader reflection as to the functioning of the judiciary and in particular the issue of judicial independence. The lack of transparency of this system is a source of concern and makes a precise assessment of corruption problematic. Complaints continue to be received and dealt with by the Ombudsman for Citizens' Rights, who has specifically criticised citizens' lack of access to justice (length of procedures and cost of legal action) in his report for 2000 presented to the Sejm in May 2001.

A recently constituted government task force on corruption is a first step in drawing together the various stands of policy and the actors involved in the fight against corruption. Some progress has been made in adopting legislative measures to combat corruption. Legislation on money laundering was adopted in December 2000. The law creates the legal framework for the establishment of the office of General Inspector of Financial Information, which will oversee financial transactions with a view to curbing money laundering. In parallel, the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime has been ratified. The convention entered into force in April 2001. On the ground, a sustained effort is required to step up the fight against corruption both by the police and the border guard service[29]. The law on public information is an important administrative development in the fight against corruption. Further measures are being undertaken to reduce the incidence of corruption in the civil service. Anti-corruption training has been upgraded and 200 people benefited from this revamped approach in 2001. Work on the code of ethics continues. Poland signed the Council of Europe Civil Law convention on Corruption in April 2001, participates in the Council of Europe Group of states against corruption (GRECO), and continues to participate in the monitoring of anti-corruption measures effected by the OECD working group on bribery in international commercial transactions.

The third remaining problem in the legal framework is the implementation of the law on bankruptcies and the exit of firms. In 2000, the number of bankruptcy procedures filed in the courts increased by 41% (more than 4,000 new cases), but problems remain with the protection of creditors and the ability to seize collateral. Commercial courts still suffer from a lack of resources and training to become more efficient. Aside from bankruptcy, the new commercial code in force since 1 January 2001 is beneficial for large firms and their consolidation through mergers or acquisitions.

2.3 Financial System[30] *(Overall rating 5)*

2.3.1 The Rules

Financial sector reform in Poland began in the 80s[31], the first major reform being the separation of the central bank, the National Bank of Poland (NBP), from the Ministry of Finance under the 1982 Banking Act. This act also legalised the formation of private banks as joint stock companies with or without foreign equity participation. The NBP continued to perform both functions of central and commercial bank until 1989, when parliament passed a new Banking Act and the National Bank of Poland Act. The Acts facilitated the conversion of approximately 400 regional branch offices of the NBP into nine regional state-owned commercial banks (for additional information on the financial system refer to appendix 2).

The NBP took on the structure and operations of a Western-style central bank – holding reserves, issuing currency, advancing credit to the banking system, overseeing the payments system and holding part of the debt of the Polish government. It also has responsibility for the supervision and regulation of the Polish banking system. The independence of the NBP was reinforced by law. The president of the NBP is nominated by the President of Poland and confirmed by parliament. A revised banking law in 1992 gave the NBP legal authority to enforce loss provisioning standards and capital adequacy ratios[32].

2.3.2 The Structure

In 1998, 83 banks operated in Poland, 31 of which were foreign owned (see exhibit 16). In the initial stages of transition, the government encouraged foreign participation.

Commercial banks dominate the banking market (with 72% of assets and 73% of net loans in 2000). The government maintains ownership of only 7 institutions, but the roles of PKO Bank Polski SA and Bank Gospodarstwa Krajowego (BGK) SA remain significant (they hold more than 30% of total bank deposits). One of the main characteristics of the sector is the high degree of foreign ownership. There are now 46 banks with majority foreign equity, representing

Exhibit: 16

	1993	1994	1995	1996	1997	1998
Number of banks	87	82	81	81	83	83
o/w domestic	77	71	63	56	54	52
Foreign	10	11	18	25	29	31
Asset share of state banks (%)	86.2	80.4	71.1	69.8	51.6	48.0
Banks per population (million)	2.3	2.1	2.1	2.1	2.1	2.1

Source: Banking Crises in Transition Economies, World Bank Policy Research Working Paper, 2000.

29 Recent data suggest that in 2000 there was a marked increase in the number of cases detected: up to 1,899 compared to 1,357 in 1999. Convictions also increased, rising from 408 in 1999 to 581 in 2000.

30 See annex for a description of the financial sector.

31 Banks pursued their own bad debt collection, which had increased post transition due to the entry of new banks, many of which ran up large losses and were undercapitalized. As a result, banks strengthened their institutional capacity. Poland was an exception among the transition countries in undertaking a parallel bank and enterprise restructuring programme – the Enterprise and Bank Restructuring Programme (1993). The key feature of the EBRP was a one-time recapitalization of the banks with the size of the capital infusion based on the value of each bank's nonperforming loan portfolio at the end of 1991 (Mondschen and Opieia, 1997).

32 The minimum capital-asset ratio requirement is 8%, although banks in the first year must hold 15% and 12% in the second year. The capital-asset ratio requirement is risk-weighted in line with the Basle guidelines. The actual risk-adjusted capital ratio at end June 1999 was 14.2%.

NON-PERFORMING LOANS (AS A % OF TOTAL LOANS)

Exhibit: 17

	1991	1992	1993	1994	1995	1996	1997	1998
Non-performing loans (% total loans)	16	30	29	28	21	13	10	10

Source: Banking Crises in Transition Economies, World Bank Policy Research Working Paper, 2000.

69.6% of the total assets of the sector at the end of last year. Financial intermediation remains low. Banking assets represented some 62% of GDP at the end of 2000, while the credit to GDP ratio is still around 20% (half of that in the Czech and Slovak Republics). The Polish equity market is in its infancy, with a capitalisation of less than 19% of GDP. Greater competition is now taking place, putting pressure on earnings in the banking sector. Banks are also facing increasing competition for retail deposits from non-bank financial firms. The interest rate spread in 2000 was still relatively high at 6.7%.

The penetration levels of the non-banking financial institutions are much lower than in Western Europe. For example General Insurance represents only 3% of the total financial market and 7.5% of leasing companies. The number of specialist mortgage firms is negligible. The non-banking sector is therefore a small and fragmented market. Pension Funds and Consumer Finance have developed well.

The Warsaw Stock Exchange had 230 companies listed by mid-2001 compared to a mere five companies ten years earlier. The increase is due to a combination of IPOs by post 1989 private companies and by the 15 mass privatisation national investment funds.

2.3.3 Management

Financial reforms, an appropriate financial framework and the development of grounds upon which to enhance competition (bank privatisation) together led to the establishment of foreign banks.

There is no immediate threat to the stability of the financial sector in the short run. Bank capitalisation has so far been adequate, and the regulatory and supervisory framework has been substantially upgraded in the recent past. This year in particular, the government's submission of the amendment to the banking law to parliament has been an important step in the right direction, in particular to empower supervisors to conduct consolidated supervision. The only source of concern at this stage for the banking sector is the sharp deterioration in asset quality witnessed over the last two years. At the end of 2000, total classified loans (i.e. comprising the three categories of irregular claims: substandard, doubtful, loss) had risen to 14.7% of total loans, from a ratio of around 10% before the start of the Russian crisis (see exhibit 17).

One of the main weaknesses of the financial sector is nevertheless its incapacity to reach the real sector of the economy. As indicated above, the credit to GDP ratio is only 20%, of which most lending is either to large corporates or consumers. SMEs, which account for 70% of total employment and almost half of GDP, have serious problems accessing financing. SME finance is being provided by specialist venture capitalists (such as Caresbac) and Bank BISE (specialist SME lender), but as mentioned above, most banks have avoided this sector, although the EBRD SME facilities over the last few years through Pekao and other banks is starting to reverse the situation.

The EU and the EBRD consider assistance in SME financing as one of their priorities in the coming years (through SME financing facilities including both debt and equity, the promotion of SME organisations and industry associations among others), as well as the encouragement of the growth of non.-bank financial institutions.

The Warsaw Stock Exchange is not a major source of industrial finance. Stock market capitalisation is low – 17% of GDP compared to 21% in Hungary and the Czech Republic – and reflects the slow pace of privatisation. On the other hand, liquidity is much greater than that of the Czech Republic market resulting from an earlier arrival of foreign investment in Poland as well as more speculative European portfolios (EIU, 2001). The corporate bond market (as well as other fixed income markets) is also small, but should develop in parallel with the growth of institutional investors.

2.4 Corporate Governance *(Overall rating 3)*

2.4.1 and 2.4.2 The Rules and Structure

The Supreme Chamber of Control (NIK)'s activities are regulated in the Constitution of April 1997, as well as the Act on the NIK of December 1994. Its main functions are to audit the execution of the state budget, the government's monetary policy guidelines, to put motions to the Constitutional Tribunal regarding the conformity of legislative acts and international agreements with the Constitution and to notify the Public Prosecutor's Office in the case of well-founded suspicion of a crime or offence. NIK is independent from the executive as its President is appointed by the Sejm with the approval of the Senate for a six-year term, with only one subsequent re-election permitted. The President of the NIK may not be a Member of the Sejm or a Senator. The Act also establishes the post of the Director General. Like the President of the NIK, neither Vice Presidents nor the Director General may be members of political parties or trade unions or hold other posts, except for being university professors. Among NIK's 1,750 employees 1,250 are auditors or audit supervisors. All of the audit staff must be educated to university level [33].

2.4.3 Management

Corruption and the lack of transparency in the overall management of public administration remain as impediments to improving corporate governance in Poland.

Public accountability and transparency is an area which still has to be improved, not only as a means to ensure that Poland's institutions improve their efficiency in service delivery but also, importantly, as is strengthens citizens' trust in the public administration.

A particularly vulnerable area with regard to corruption is the public procurement of works, goods, and services. Of particular notice is the misprocurement on large state contracts that sometimes exceed market prices by a wide margin, at substantial cost to the state. In the past, problems of particular concern were identified with respect to large IT contracts and road and other construction projects. Possibly some of the problems were caused by incompetence, but most reports clearly identified corruption. This experience raises questions about the adequacy of fiscal and governance controls and accountability mechanisms in all spheres of government, including state-owned enterprises. The government needs to take a number of steps to improve legal and governance systems in this area. One helpful step improving transparency and efficiency would be the preparation of standard bidding documents for different types of procurement.

Efforts to reduce corruption have so far focused on attempts to introduce formal

33 The audit staff is composed of: 30% lawyers, 25% economists, 29% graduates in science, agriculture and related fields, with 67 PhDs, 26 persons with more than one degree and 23 graduates of the National School of Public Administration.

ethics standards at Parliamentary level; on the passing of laws including a law on financial disclosure, and on the reliance on police and enforcement efforts. A "Clean Hands" campaign in the early 90s made a strong start but effective implementation and follow-through unfortunately did not materialise. A deregulation task force was set up but has not yet been able to make significant impact. These efforts, while commendable in themselves, have missed the broad middle ground in which political elites and the state administration actually operate – and where many have a strong interest in resisting change. There is a need to strengthen the legislative framework with some specific, closely defined pieces of legislation, but in general the emphasis has tended to be too much on the passing of laws rather than their effective implementation. Overall, Poland has most of the instruments it needs but not as yet sufficient will and capacity to use them well. However, the recent strategy document released by the government recognises that corruption endangers the proper functioning of the state and indicates that some appropriate measures will be put in hand.

Application of the Principles of Corporate Governance (Private)

Poland has strict regulatory mechanisms for its capital markets aimed at investor protection from management or large block-holder fraud. It has put considerable effort into enforcement mechanisms (effectiveness), often the most deficient part of the legal framework in transition economies, which have tended to concentrate only on the quality of the law (extensiveness). According to research by Anete Pajuste of the Stockholm School of Economics (April 2002), there is a direct correlation between this effectiveness and stock market returns. The EBRD Index on Financial Regulations (exhibit 18) shows the strong standing of Poland when compared to its Central European neighbours.

A number of legal conflicts exist between various stakeholders on the strategic direction of individual companies, in particular in cases where a strategic investor holds a minority stake but where the State remains a majority passive owner or maintains special rights. In banning the use of stocks with multiple voting rights and increasing the prerogatives of the annual shareholder meetings, the new commercial code contributes to higher standards in this area. Further efforts to protect minority shareholder rights are nevertheless needed, and should be helped by the progressive development of the stock market and the role of pension funds.

EBRD INDEX (FINANCIAL REGULATIONS)

Exhibit: 18

	Financial Regulations					
	Extensiveness			Effectiveness		
Czech	3.3	3.3	4	2.7	2.3	2.7
Estonia	3.3	4	4	2.7	3.3	2.7
Hungary	4	4	4	4	4	4
Poland	*4*	*4*	*4*	*3*	*4*	*4*
Slovenia	3.3	3.3	4	2.7	3.3	4
Latvia	3.3	3	3	2.3	2	3
Lithuania	2.7	2.7	4	2	2	3.7
Average	**3.32**	**3.48**	**3.78**	**2.68**	**2.99**	**3.31**

Source: EBRD

GOVERNANCE INDICATORS FOR POLAND, 1997/98 AND 2000/01

Exhibit: 19

Governance Indicator	Year	Percentile Rank* (0-100), in %	Estimate (-2.5 to +2.5)	Standard Deviation	Number of surveys/ polls
Voice and Accountability	2000/01	86.8	+1.21	0.16	8
	1997/98	82.8	+1.12	0.19	6
Political Stability /NoViolence	2000/01	72.8	+0.69	0.22	9
	1997/98	80.8	+0.84	0.22	7
Government Effectiveness	2000/01	62.5	+0.27	0.17	11
	1997/98	80.3	+0.67	0.21	8
Regulatory Quality	2000/01	67.5	+0.41	0.26	8
	1997/98	71.3	+0.56	0.19	7
Rule of Law	2000/01	70.6	+0.55	0.15	11
	1997/98	70.7	+0.54	0.16	10
Control of Corruption	2000/01	69.6	+0.43	0.15	12
	1997/98	73.1	+0.49	0.16	9

Source: Kaufmann, Kraay and Zoido (KKZ), 2002: Governance Matters II: Updated Governance Indicators for 2000-01
* The percentile rank indicates the percentage of countries world-wide that rate below the selected country, here Poland, subject to a margin of error.

Recent governance indicators[34] show (see exhibit 19) that Poland has worsened across all indicators except for Voice and Accountability when comparing 2000/01 with 1997/98, possibly suggesting government relaxation in strengthening corporate governance.

2.5 Trade and competition
(Overall rating 4)

2.5.1 The Rules

Trade

Throughout the transition period, Poland has liberalised its trade mainly due to agreements with the EU. In 1999, in conforming to the Europe Agreement, Poland abolished import tariffs on manufactured goods from the EU (with the exception of some sensitive sectors). Trade liberalisation is also taking place in accordance with WTO agreements and trade polices have been harmonising with EU trade polices for Poland's accession to the EU.

Poland is a member of the Central European Free Trade Agreement (CEFTA), which has seven members (Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Romania and Bulgaria). Yet, CEFTA only accounts for a small proportion of trade. Poland also holds free trade agreements with Turkey, the Baltic States and Israel.

Regarding agricultural products, a new agreement on reciprocal concessions entered into force in January 2001 on an autonomous basis, pending the conclusion of an Additional Protocol to the Europe Agreement. As a result, approximately 91% of traditional EU agricultural imports from Poland are duty-free, while 43% of the EU agricultural exports to Poland are exempt from duties. A second round of bilateral negotiations for trade liberalisation is presently being prepared and would cover more sensitive sectors, in which existing trade is low, in particular due to a high degree of tariff protection. In the fisheries sector, negotiations on mutual concessions were concluded in July 2001. Negotiations concerning processed agricultural products are ongoing.

There remain a number of outstanding issues with regard to the implementation of the Europe Agreement, from complex long-standing issues such as steel restructuring and Special Economic Zones, to product-specific trade issues.

Customs union

Steady progress has been achieved by

34 "Governance Matters II Updated Indicators for 2000/01", Kaufmann, D., A. Kraay and P. Zoido-Lobatón (2002) and "Aggregating Governance Indicators" World Bank Policy Research Department Working Paper, No. 2195. Kaufmann, D., A. Kraay and P. Zoido-Lobatón (1999).

Poland in the field of customs. Alignment between Polish legislation and the EU Customs Code and its implementing provisions has been virtually completed through the Amendment to the Customs Code, enforced in March 2001. This covers binding origin information, processing under customs control, temporary importation and re-exportation. Regarding the customs acquis outside the Customs Code, an Ordinance of the Minister of Finance notably removed (as from January 2001) the use of customs clearance fees as a means of financing the Customs Service. The latter is now entirely supported by the Polish national budget. The Ordinance also brought the Customs Service directly under the control of the Ministry of Finance. During the reporting period, Poland incorporated the Convention on Customs Treatment of Pool Containers used in International Transport into its legislation. Concerning administrative capacity, the December 2000 amendments to the Customs Code law, the VAT law and the excise law entered into force in March 2001.

2.5.2 The Structure

The body responsible for trade supervision and regulation is the Trade department under the Ministry of Economy, while the body responsible for overseeing Competition is the Office of Competition and Consumer Protection. The Prime Minister appoints the head of each office. They are perceived to be doing their job well and are complying with EU norms.

2.5.3 Management

Customs

The "Business Strategy for the Polish Customs Administration until 2002" is being implemented. The Polish Customs Administration is currently undergoing a comprehensive process of modernisation and development of computer-based management and control:

- A national IT system monitoring tariff ceilings (INTA SAD) was implemented in April 2001. The computerised Integrated Customs Tariff system (ISZTAR) and legal information system (ALEXIS) are nearing completion. Other systems are under development for: the maintenance and distribution of data (CELESTA), finance and accounting (ZEFIR), customs declaration (CELINA) and a transit system (NCTS).
- An administrative rationalisation of local offices is taking place. New regional customs laboratories have been opened in Bialystok, Wroclaw and Koroszczyn.
- Customs offices have been supplied with the latest customs inspection equipment, while a number of measures have been undertaken to improve the integrity of the Customs service.
- Wages have been increased to address one of the causes of corruption and to attract more university graduates.
- In the continuing fight against corruption, the Customs Ethics Code was completed in September 2000. A guide of several dozen pages containing comments on doubtful and debatable cases supplements the Code.

Smuggling continues to be a problem. During 2000 seizures of smuggled alcohol and tobacco increased by 50% and a 66% respectively. Legal proceedings were initiated in over 20,000 cases concerning smuggling attempts, three quarters of which took place on Poland's Eastern border.

With the enforcement in March 2001 of the Amendment to the Customs Code and the adoption of additional implementing measures, Poland has achieved a high level of legislative alignment, and on the basis of the clear indicators of progress in the implementation of the Business Strategy, it appears that it is making strides in improving its administrative capacity – although corruption remains a concern. Poland is a party to the essential customs conventions. Increasing the speed of implementation of the computerisation systems with a view to interconnect with EC computerised systems is now crucial, and sufficient budgetary resources and logistical support need to be provided.

3. CONCLUSIONS

Poland is today considered one of the most advanced transition countries in Central and Eastern Europe and although growth has slowed down during the last two years, the country remains poised for EU Accession in 2003. Consecutive governments have introduced a number of economic, social and institutional reforms which have driven the growth of the economy (70% of GDP is now generated by the private sector), but major challenges remain if the country is to reach its development potential. While Poland has achieved "high human development" according to the UNDP, it still only ranks 38 in the Human Development Index with a GDP per capita of US$8,450 (PPP 1999).

Poverty, at 18.4% of the population (down from 27%) according to the World Bank, is particularly prevalent in the regions where there is high unemployment (over 20% in some regions) and that are dominated by an undeveloped agricultural sector and poor infrastructure.

Reform efforts have mainly been focused on rules and structure of its institutions, but public administration and the judiciary are widely perceived to be inefficiently managed and corrupt, preventing the realisation of the country's potential.

Thus, while Poland can generally speaking be considered a "success story" in its development, this development has not reached all parts of society. Our analysis of the country's institutional infrastructure explains that while overall the country's institutions merit a combined high score of 4, the management of the judiciary and of public administration merits a low score of 2, due to slow inefficient processes, a large degree of perceived corruption, and insufficient human and financial resources to adequately manage the introduction and implementation of ongoing reforms. While judicial reforms aimed at speeding up court cases have been implemented, these are still in their infancy and only a small dent has been made on reduction of backlogs. Similarly, the constraints on public administration are also beginning to undermine the ability of the state to absorb EU and other aid funds effectively. Within this context, an important emerging issue for Poland is the question of how to upgrade the quality, efficiency and effectiveness of state administration. Such an effort requires actions to inter alia, improve salaries and working conditions (so that the administration can attract, train and keep qualified and experienced personnel), streamline ministerial functions, procedures and the decision making process, and reduce unnecessary controls and regulations.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD		Quality[35]					
		1	2	3	4	5	6
Political System	Rules				X		
	Structure				X		
	Management[36]		X				
	Combined Rating			**X**			
Legal Framework	Rules				X		
	Structure				X		
	Management		X				
	Combined Rating			**X**			
Financial System	Rules					X	
	Structure					X	
	Management				X		
	Combined Rating					**X**	
Corporate Governance	Rules			X			
	Structure			X			
	Management		X				
	Combined Rating			**X**			
Trade & Competition	Rules				X		
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Overall Rating					**X** **3.6**		

35 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good
36 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Legal Framework	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Financial System	Objective Setting & Accountability				X		
	Quality of Personnel					X	
	Effective Decision Making					X	
	Efficiency of Procedures					X	
	Costs / Waste					X	
	Corruption					X	
	Combined Score					**X**	
Corporate Governance	Objective Setting & Accountability			X			
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Trade & Competition	Objective Setting & Accountability				X		
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures				X		
	Costs / Waste				X		
	Corruption				X		
	Combined Score				**X**		

WORLD BANK AND IADB MAIN ACTIVITIES IN POLAND

World Bank activities

Date	Project	Sector	Value (US$ million)	Lending Instrument	Implementing Agency
2001	Hard Coal Sector Adjustment Loan Project (02)	Mining	IBRD 100	Sector Adjustment Loan	n/a
2001	Krakow Energy Efficiency Project	Electric Power & Other Energy	IBRD 15	Specific Investment Loan	Municipal District Heating Co. of Krakow
2001	Railway Restructuring Project	Transportation	IBRD 101.4	Specific Investment Loan	Polskie Koleje Panstwowe S.A.
2000	Land Administration and Registration Project	Public Sector Management	0	n/a	Office of the Minister Plenipotentiary (CADASTRE)
2000	Szczecin-Swinoujscie Seaway and Port Modernization Project	Transportation	IBRD 38.5	Specific Investment Loan	Min. of Transport & Maritime Economy
2000	Geothermal and Environment Project (GEF)	Environment	Grant 5.4	Specific Investment Loan	Pec Geotermia Podhalanska, S.A.
2000	Podhale Geothermal district Heating	Electric Power & Other Energy	IBRD 38.2	Specific Investment Loan	Pec Geotermia Podhalanska, S.A.
2000	Rural Development Project	Water Supply & Sanitation	IBRD 120	Specific Investment Loan	MARD, Ministry of Finance, self-governments
2000	Monitoring and Evaluation System Project	Urban Development	0	N/A	Min. of Finance
1999	European Union Accession Project	Public Sector Management	0	N/A	Office of the governments Plenipotentiary
1999	Rural Environmental Protection Project - GEF	Environment	Grant 3	Specific Investment Loan	National Fund for Env. Protection
1999	Rural Environmental Protection Project	Environment	IBRD 15.8	Learning and Innovation Loan	National Fund for Env. Protection
1999	Hard Coal Sector Adjustment Loan Project	Mining	IBRD 300	Sector Adjustment Loan	Ministry of Economy
1998	Second Wholesale Markets Project	Agriculture	IBRD 11.12	Sector Adjustment Loan	Lubelska Gielda Rolno Grodnicza SA
1998	First Wholesale Markets Project	Agriculture	IBRD 15.9	Sector Adjustment Loan	Ministry of Agriculture and Food Economy
1997	Emergency Flood Recovery Project	Urban Development	IBRD 200	Emergency Recovery Loan	MoF, Office of the Minister of Flood Recovery
1997	Second Roads Project	Transportation	IBRD 300	Specific Investment Loan	GDDP (General Directorate of Public Roads)
1997	Municipal Finance Project	Finance	IBRD 22	Financial Intermediary Loan	BISE
1997	Ozone Depleting Substances Phaseout Project	Environment	Grant 6.21	Specific Investment Loan	Polish Ministry of Economy (formerly Industry and Trade)
1996	Institutional Development for Social Security Reform Project	Social Protection	0	n/a	Office of the Plenipotentiary for Social Security Reform
1996	Port Access and Management Project	Transportation	IBRD 67	Specific Investment Loan	Ministry of Transport

Date	Project	Sector	Value (US$ million)	Lending Instrument	Implementing Agency
1996	Bielsko-Biala Water and Wastewater Project	Water Supply & Sanitation	IBRD 21.5	Specific Investment Loan	Aqua
1995	Power Transmission Project's	Electric Power & Other Energy	IBRD 160	Specific Investment Loan	Polish Power Grid co
1994	Katowice Heat Supply and Conservation Project	Electric Power & Other Energy	IBRD 45	Specific Investment Loan	PEC Katowice
1994	Coal - to - Gas Conversion Project	Electric Power & Other Energy	Grant 25	Specific Investment Loan	Bk for Envir. Proteceat companies
1994	Debt & Debt Service Reduction Loan Project	Economic Policy	IBRD 170	Debt and Debt Service Reduction Loan	Ministry of Finance
1993	Forest Development Support Project	Agriculture	IBRD 146	Specific Investment Loan	Min. of Environment
1993	Enterprise and Financial Sector Adjustment Loan Project	Economic Policy	IBRD 450	Structural Adjustment Loan	Ministry of Finance
1993	Agriculture Sector Adjustment Loan Project	Agriculture	IBRD 300	Structural Adjustment Loan	M/finance-m/agric.
1993	Roads Project	Transportation	IBRD 150	Specific Investment Loan	Ministry of Transport
1992	Housing Project	Finance	IBRD 200	Sector Investment and Maintenance Loan	Mortgage fund (NBP), Polish agency for regional devt.(PARR)
1992	Health Services Development Project	Health, Nutrition & Population	IBRD 130	Specific Investment Loan	Min of Health
1992	Private Enterprise Development Project	Private Sector Development	IBRD 60	Financial Intermediary Loan	PDB & govt. of Pol
1991	Forest Biodiversity Protection Project	Agriculture	0	Specific Investment Loan	TBD
1991	Heat Supply Restructuring & Conservation Project	Electric Power & Other Energy	IBRD 340	Specific Investment Loan	District heat COMPANEAT companies
1991	Financial Institutions Development Loan Project	Finance	IBRD 200	Sector Adjustment Loan	TBD
1991	Privatisation & Restructuring Project	Private Sector Development	IBRD 280	Specific Investment Loan	GOV/IDA/PDB
1991	Agricultural Development Project	Agriculture	IBRD 100	Financial Intermediary Loan	NBP/Banks
1991	Employment Promotion & Services Project	Social Protection	IBRD 100	Specific Investment Loan	MoL
1991	Telecommunications Project	Telecomm. & Informatics	IBRD 120	Sector Investment and Maintenance Loan	PTT
1990	Structural Adjustment Loan Project	Multisector	IBRD 300	Structural Adjustment Loan	Ministry of Finance
1990	Energy Resource Development Project	Oil & Gas	IBRD 250	Sector Investment and Maintenance Loan	Coal & gas/oil companies
1990	First Transport Project	Transportation	IBRD 153	Specific Investment Loan	Hway ad.& Pol. rail.
1990	Environment Management Project	Environment	IBRD 18	Technical Assistance Loan	Ministry of Environ.
1990	Industrial Export Development Project	Finance	IBRD 260	Specific Investment Loan	TBD
1990	Agroindustries Export Development Project	Agriculture	IBRD 100	Specific Investment Loan	TBD Y.

ADDITIONAL INFORMATION ON THE FINANCIAL SYSTEM

1-Entry		Poland
1.1 Licensing authority		The Commission for Banking Supervision in agreement with the Minister of Finance
1.2 Number of banks		80
1.3 Minimum capital entry requirement		Euro 5
1.4 Is information on source of funds for capital required?		yes
1.5 Are the sources of funds to be used as capital verified by authorities?		yes
1.5.1 Are law enforcement authorities consulted?		yes
1.6 Can assets other than cash/govt. securities be used to increase capital?		yes
1.7 Can borrowed funds be used?		no
1.8 Legal submissions required for banking license:	1.8.1 Draft by-laws	yes
	1.8.2 Intended organization chart	yes
	1.8.3 First 3-year financial projections	yes
	1.8.4 Financial information on shareholders	yes
	1.8.5 Background/experience of future directors	yes
	1.8.6 Background/experience of future managers	no
	1.8.7 Sources of funds in capitalization of new bank	yes
	1.8.8 Intended market differentiation of new bank	yes
1.9 Number of domestic applications for banking licenses		8
1.9.1 Number denied		0
1.10 Number of foreign applications for banking licenses		12
1.10.1 Number denied		0
1.11 Basis for denial of applications	1.11.1 Capital amount/quality	
	1.11.2 Banking skills	
	1.11.3 Reputation	
	1.11.4 Incomplete application	
2-Ownership		**Poland**
2.1 Is there a maximum percentage of capital that can be owned by single owner?		no
2.1.1 If yes, what is it?		
2.2 Can related parties own capital in a bank?		yes
2.2.1 If yes, what is the maximum percentage?		none
2.3 Regulatory restrictiveness of ownership by nonfinancial firms of banks		unrestricted
2.4 Fraction of capital in 10 largest banks owned by conglomerates		information not available
2.5 Can non-bank financial firms own shares in banks?		yes
2.5.1 What are the limits?		none
2.6 What is the 5-bank concentration ratio (%)?		57.2

3-Capital		Poland
3.1 Minimum capital-asset ratio requirement (%)		8, though in the first year of banks' activity 15% is required, and subsequently 12% in the second year
3.1.1 Is it risk-weighted in line with Basle guidelines?		Yes
3.2 Does the ratio vary with a bank's credit risk?		No
3.3 Does the ratio vary with market risk?		No
3.4 Actual risk-adjusted capital ratio (%)		14.2 as of end Jun 1999
3.5 Is subordinated debt allowable (required) as part of capital?		Yes
3.6 What fraction of revaluation gains is allowed as part of capital?		None
3.7 Percentage of banking system's assets in banks that are 50% or more government owned		43.7
3.8 Percentage of banking system's assets in banks that are 50% or more foreign owned		26.4
3.9 Before minimum capital adequacy is determined, which items are deducted from capital	3.9.1 Market value of loan losses	No
	3.9.2 Unrealised securities losses	Yes
	3.9.3 Unrealised foreign exchange losses	Yes
4-Capital		**Poland**
4.1 Securities		Permitted
4.2 Insurance		Restricted
4.3 Real estate		Restricted
4.4 Regulatory restrictiveness of bank ownership of nonfinancial firms		Permitted
5 & 6 -Audit, management, org		**Poland**
5.1 Is an external audit compulsory?		Yes
5.2 Are there specific requirements for the extent of audit ?		Yes
5.3 Are auditors licensed or certified?		Yes
5.4 Is auditor's report given to supervisory agency?		Yes
5.5 Can supervisors meet external auditors to discuss report without bank approval?		No
5.6 Are auditors legally required to report misconduct by managers/directors to supervisory agency?		Yes
5.7 Can legal action against external auditors be taken by supervisor for negligence?		No
5.8 Has legal action been taken against an auditor in last 5 years?		
6.1 Can supervisors force banks to change internal organizational structure?		No
6.2 Has this power been utilized in last 5 years?		
7-Liquidity		**Poland**
7.1 Are there guidelines for asset diversification?		No
7.2 Are banks prohibited from making loans abroad?		No
7.3 Minimum liquidity requirement (%)		None
7.4 What interest is paid on reserves?		
Minimum reserve requirement (%)		5%, applicable from Sept. 1, 1999
How is reserve requirement remunerated		Not remunerated
7.5 What assets satisfy liquidity or reserve requirements?		

8-Depositor		Poland
8.1 Is there an explicit deposit insurance scheme?		Yes
8.1.1 Is it funded by the government, banks or both?		Banks
8.1.2 Ratio of accumulated funds to total bank assets		0.0017 (as of 6/30/99)
8.1.3 Insurance limit per account		
8.1.4 Is there a limit per person?		Yes
8.1.4.1 Amount of limit		Euro 8,000; Euro 11,000 as of 1/1/2000; Euro 15,000 as of 1/1/2001; Euro 17,000 as of 1/1/2002; Euro 20,000 as of 1/1/2003
8.1.5 Does deposit insurance authority make the decision to intervene a bank?		No
8.1.6 If no, who does?		Commission of Banking Supervision
8.1.7 If yes, does the deposit insurance authority have the legal power to intervene/takeover a troubled (not insolvent) bank?		
8.2 As a share of total assets, value of denominated debt liabilities not covered by explicit/implicit savings protection scheme?		Not available
8.3 Number of banks merged/closed (as part of failure resolution) in last 5 years		18
8.4 Were depositors wholly compensated the last time a bank failed?		Yes
8.4.1 Average time to pay depositors in full		72 days in 1998
8.4.2 Longest that depositors waited in last 5 years		135 days in 1995 (year when the law on Bank guarantee Fund became effective)
8.5 Were any deposits that were not covered at the time of failure compensated when bank failed?		Yes
8.6 Can deposit insurance agency take legal action against bank directors/officials?		No
8.7 Has the deposit insurance agency ever taken any legal action against bank directors/officials?		
9-Provisioning		**Poland**
9.1 Is there a formal definition of "non-performing loan"?		Yes
9.1.1 If yes, what is it?		Loan whose principal or interest is due for over 30 days; or if the financial position of the debtor could potentially negatively affect the repayment schedule
9.2 Classification of loans in arrears:	9.2.1 Substandard	30 to 90
	9.2.2 Doubtful	90 to 180
	9.2.3 Loss	180+
9.3 Minimum required provisioning of loans as they become:	9.3.1 substandard	20
	9.3.2 doubtful	50
	9.3.3 loss	100
9.4 Other classification systems		
9.5 Ratio of non-performing loans to total assets (%)		0.047 (as of end June 1999)
9.6 If one loan is non-performing, are other loans of a multiple-loan customer classified as non-performing?		Yes

10-Disclosure		Poland
10.1 Does income statement contain accrued but unpaid interest/principal while loan is performing?		Yes
10.1.1 Does income statement contain accrued but unpaid interest/principal while loan is non-performing?		No
10.2 Number of days in arrears after which interest income cease to accrue		30
10.3 Are consolidated accounts covering bank and any non-bank financial subsidiaries required?		Yes
10.4 Are off-balance sheet items disclosed to supervisors?		Yes
10.4.1 Are off-balance sheet items disclosed to public?		Yes
10.5 Must banks disclose risk management procedures to public?		No
10.6 Are directors legally liable for erroneous/misleading information?		Yes
10.6.1 Have penalties been enforced?		No
10.7 Do regulations require credit ratings for commercial banks?		No
10.7.1 What percentage of top ten banks is rated by international credit rating agencies?		80
10.7.2 What percentage of the top ten banks are rated by domestic credit rating agencies?		Yes
10.7.3 Which bank activities are rated?	10.7.3.1 bonds	Yes
	10.7.3.2 commercial paper	Yes
	10.7.3.3 other	

11-Discipline		Poland
11.1 Are there any mechanisms of cease-desist type orders whose infraction leads to automatic imposition of civil & penal sanctions on banks directors & managers?		Yes
11.2 Can the supervisory agency order directors/management to constitute provisions to cover actual/potential losses?		Yes
11.3 Can the supervisory agency suspend director's decision to distribute:	11.3.1 dividends	Yes
	11.3.2 bonuses	Yes
	11.3.3 management fees	Yes
11.4 Any such actions taken in last 5 years?		Yes
11.5 Which laws address bank insolvency?		Banking Law; The Act of the National Bank of Poland
11.6 Can the supervisory agency supersede bank shareholder rights and declare bank insolvent?		Yes
11.7 Does banking law allow supervisory agency to suspend some or all ownership rights of a problem bank?		Yes
11.8 Does the law establish pre-determined levels of solvency deterioration which forces automatic actions such as intervention?		No
11.9 Regarding bank restructuring & reorganization, can supervisory agency or any other govt. agency do the following:	11.9.1 supersede shareholder rights	Yes
	11.9.2 remove and replace management	Yes
	11.9.3 remove and replace directors	Yes
	11.9.4 forbear certain prudential regulations	Yes
	11.9.5 insure liabilities beyond any explicit deposit insurance scheme	No

11.10 Number of banks closed in last 5 years		5
11.10.1 Percentage of total bank assets accounted for by these banks		Approx. 0.06
12-Supervision		**Poland**
12.1 Bank Supervision Authority		The Commission for Banking Supervision
12.1.1 Is there more than one supervisory body?		yes; there are different supervisors for other financial institutions
12.2 To whom are supervisors accountable?		Accountable to the Public
12.2.1 How is head of supervisory agency/other directors appointed?		The Commission is chaired by the President of the Central Bank who is appointed by the lower chamber of the Parliament. In agreement with the Minister of Finance, the President of the central bank appoints General Inspector for Banking Supervision who becomes a member of the Commission and leads General Inspectorate for Banking Supervision, executive body of the Commission
12.2.2 How is head of supervisory agency/other directors removed?		Members of the Commission, including chairperson, cannot be removed from their functions exercised in the Commission. They cease their functions when they are removed from their official posts. The above doe not apply to representative of the President and representative of the Minister of Finance, who can be removed by the bodies designating them
12.3 Any important differences between expectations from supervisory agency and what is mandated by law?		none
12.4 Total number of professional bank supervisors		496, including 325 on-site inspectors (as of end Oct 1999)
12.4.1 Number of professional bank supervisors per institution		0.5
12.5 Number of onsite examinations per bank in last 5 years		Approx. 1.5
12.6 Total budget for supervision		PLN 0.05 (1999)
12.7 Frequency of onsite inspections conducted in large & medium size banks (annually=1; every two years =2)		Every 3 years though the aim is 1 every 2 years
12.8 Average tenure of a supervisor (years)		9.5
12.9 Frequency of supervisors employed by banking industry subsequent to retirement (never=0, rarely=1, occasionally=2; frequently=3)		1
12.10 Must infraction of any prudential regulation found by a supervisor be reported?		Yes
12.11 Any mandatory actions in these cases?		Yes
12.12 Who authorizes exceptions to such actions?		The Commission for Banking Supervision
12.13 Number of exceptions granted last year		0
12.14 Are supervisors legally liable for their actions?		Yes

COUNTRY REPORT
TRINIDAD AND TOBAGO
BUILDING SUCCESS ON A STRONG HERITAGE

1. DEVELOPMENT PERFORMANCE

The development performance of Trinidad and Tobago has been strongly influenced by both its geophysical endowment and its historical heritage prior to independence and its political evolution since.

1.1 Economic performance

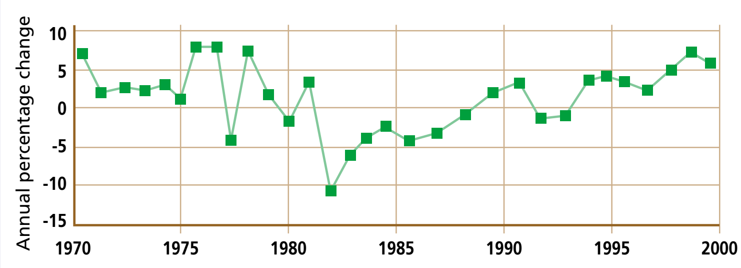
Since the first oil price adjustment in the early seventies, Trinidad and Tobago's oil and gas resources have become the main drivers behind development performance, although the volatility of energy prices have exacerbated revenue fluctuations. Oil and gas revenues have on the whole been well managed and not been diverted to non-economic uses as has happened in many developing countries. Building on these energy resources Trinidad and Tobago has developed the most diversified and industrialised economy in the English-speaking Caribbean.

Economic performance measured in terms of Real GDP growth has been highly correlated with oil price fluctuations since the discovery of oil in the second half of the 20th century. This was particularly evident in the 70s. Real GDP growth of 7.8% in 1976 decreased by 1.9% in 1978 before increasing by 7.8% a year later (see exhibit 1). The decline of oil prices in the 80s hit the domestic economy hard with: real GDP recording a fall of 4% a year, an increase in unemployment and significant migration of relatively skilled labour.

The falling of oil prices in the 80s soon gave way to fiscal deficits as revenue. The fiscal situation was compounded by the government's expansion of the public sector in the 70s, made possible by strong GDP growth. As shown in exhibit 2, the government deficit reached its highest deficit value in 1988 accounting for –5.7 as a percentage of GDP. As a consequence, external debt increased sharply, reaching 49% of GDP in 1988. To cope with this challenge, in 1988, the World Bank and IMF introduced economic reforms through a Structured Adjustment Loan.

REAL GDP GROWTH IN TRINIDAD AND TOBAGO

Exhibit: 1



Source: IMF

SOME INDICATORS (AS A PERCENTAGE OF GDP)

Exhibit: 2

	1972	1979	1980	1981	1985	1988	1989	1991	1995	1997	1999	2000
Govt deficit (-) / surplus	-1.9	-0.6	7.4	3.3	-5.1	-5.7	-3.9	-0.2	0.2	0.1	-0.6	-0.6
External debt	11.2	14.8	13.2	15.0	19.6	46.7	49.4	48.0	51.5	36.9	35.8	-

Source: Compiled from International Financial Statistics: IMF, various

Following the 80s economic downturns, successive administrations sought to diversify the economy away from its natural resources of oil and gas. The reforms helped to reduce public spending and to diversify the economy:

- After averaging 4.3% of GDP in the latter half of the 80s, a primary surplus of 0.2% was recorded in 1995. Over this period, the authorities revised the tax regime, introduced VAT, deepened trade liberalization, removed price controls on consumer items, divested about 50% of the assets of the state-owned enterprises and initiated retrenchment of staff in statutory agencies.
- In the last decade the petroleum sector as a percentage of GDP decreased from 26.2% in 1991 to 23.5% in 2001.

Since economic reforms finished in 1994, the economy has been relatively stable and grown at an average of 4 % a year, mostly as a result of an increase of foreign investment in natural gas related industries and a spurt of growth in the services sector[37].

Since the mid-90s, the privatisation of state-owned assets, which started in the late 80s[38], and advance payments for oil exploration contracts boosted government revenues. On the other hand, reform of income taxes, large investment related write-offs; the drop in world oil prices and a reduction in external tariffs have reduced revenue.

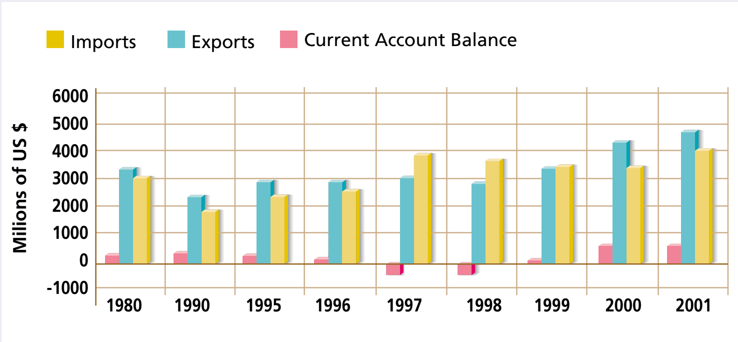
Trinidad and Tobago rescheduled its debt with the Paris Club in 1988 and has met all of its repayment obligations on schedule. It has secured a Moody's (sovereign) rating of Ba1 and regained access to private capital markets. Trinidad and Tobago was not affected by the Mexican, Brazilian, Russian and Asian financial crises, although it did face a higher cost of borrowing (12-13%) when it tried to access international financial markets in 1998. Domestic debt stock is about 22% of GDP. Trinidad and Tobago has provided a disproportionate share of debt relief to Guyana under Naples terms and more recently under the Highly Indebted Poor Countries (HIPC) initiative (World Bank, 1999).

37 The IMF Article IV public information notice attributes Trinidad and Tobago's strong economic performance in the 90s to the 'sound policies and significant new energy-related investments' (IMF, 2001).

38 Telecommunications, electricity generation, air transport and a cluster of large manufacturing and processing companies were privatised between 1995 and 2000. However both the power distribution and the water utilities continue to operate under state ownership and there is state involvement in the oil and gas sectors as well as tourism. The loss-making CARONI sugar company, also under state ownership, accounts for more than half national agricultural production. Its restructuring has been persistently deferred and remains an obstacle to implementing a broader range of reforms in the agricultural sector.

TRADE IN TRINIDAD AND TOBAGO

Exhibit: 3



Source: Global Development Finance, 2001

MAIN-TRADING PARTNERS (% OF TOTAL EXPORTS)

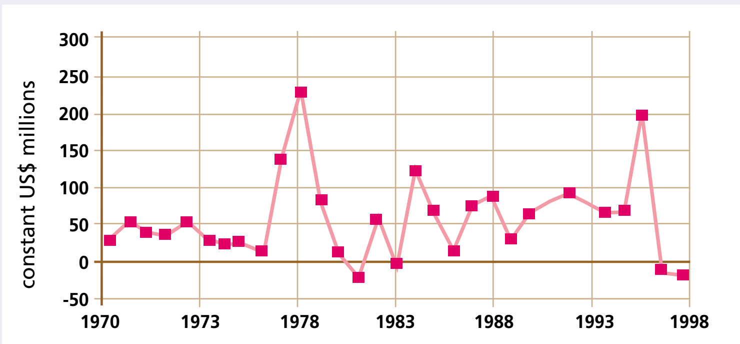
Exhibit: 4

Countries	1993	1994	1995	1996	1997	1998	1999
United States	45.6	42.9	38.9	44.3	39.7	36.9	39.3
CARICOM	20.2	20.0	20.0	23.9	24.5	29.4	26.1
Other	16.3	16.1	18.9	11.0	11.5	13.0	17.8
Central and South America*	7.3	10.2	8.5	7.6	10.6	10.1	10.0
European Community	2.8	6.2	7.4	4.8	8.2	6.0	5.7
Puerto Rico and the US Virgin Islands	2.7	2.9	2.9	4.8	4.5	3.0	3.1
Canada	2.1	0.5	1.8	2.3	0.9	1.2	1.4
Japan	1.1	0.2	0.1	0.3	0.1	0.1	0.1

Source: Central Statistical Office, Trinidad and Tobago * Excluding Guyana, French Guyana, Surinam and Belize

NET PUBLIC FLOWS EVOLUTION (ODF) IN TRINIDAD AND TOBAGO

Exhibit: 5



Source: OECD DAC database.

NET ODF – BILATERAL AND MULTILATERAL COMPONENTS (% SHARE)

Exhibit: 6

		1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
Net ODF		**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
	ODA	51.6	26.2	9.8	39.4	13.5	27.2
	OOF	48.4	73.8	90.2	60.6	86.5	72.8
Bilateral		**34.5**	**53.9**	**95.3**	**3.8**	**3.7**	**1.1**
	ODA	25.6	8.3	-0.2	27.7	-1.1	-0.9
	OOF	8.9	45.6	95.4	-23.9	4.8	2.0
Multilateral		**65.5**	**46.1**	**4.7**	**96.2**	**96.2**	**98.8**
	ODA	26.0	17.9	10.0	11.8	14.5	28.0
	OOF	39.5	28.2	-5.3	84.4	81.6	70.8

Source: OECD DAC online database

1.2 Trade

Trinidad and Tobago has liberalized most of its trade with very few products continuing to require an import license. Trinidad and Tobago trade revenues derive from oil and oil-related products exports and foreign exchange earnings. Exhibit 3 shows the volume of exports versus imports over the last two decades.

Major exports from Trinidad and Tobago are mainly energy based (crude oil and refined petroleum products, etc.) and those accounted for 45% of total export earnings in 2000. Other export products are: agricultural products and manufactured goods such as beverages, foodstuffs and motor vehicles batteries. Major imports in Trinidad and Tobago are machinery, equipment and parts, metal ores, paper manufacturers and road vehicles.

The main trading partners during the 90s were the USA, the Caribbean region and the EU (see exhibit 4). Exports benefit both from Trinidad and Tobago's relative proximity to the US and its position as one of the larger States in the Caribbean sub-region. An import share of USA exports consists of fuel-related products. A significant market is provided regionally by members of CARICOM, the Caribbean Common Market established with the objectives of promoting integration of economies of its 15 members.

1.3 Development aid

Official Aid flows

Net public flows have fluctuated over the last thirty years having finished the period with net ODF less than what it was at the beginning in 1970 (see exhibit 5). This trend is highly correlated with the drop in oil prices; the sharper the oil price decline the more aid was needed.

Net ODF averaged about US$30 million in real terms (1999 constant US$) over the 70s, recording a high of US$241 million in 1980 following the 1979 oil price shock. Net ODF declined to US$22 million on average to 1986 when it recorded another high of US$126.5 million. Net ODF has averaged over US$66 million over the 90s and stood at US$203 million in 1998. Repayments in 1999 and 2000 resulted in a net ODF figure of (-US$21.4 million).

Based on 5-year averages, multilateral organizations provide the majority of net ODF to Trinidad and Tobago, except over the period 1980 to 1984. Multilateral ODF accounted for 98% of total ODF advanced to the country in 1995 to 1999 (US$80.3m). The majority of this aid has been OOF. Unsurprisingly, net OOF accounts for a significant proportion, in excess of 70% for four of the six sub-periods shown in exhibit 6.

The World Bank has not had a major presence in Trinidad and Tobago, but in 1988 introduced the Structural Adjustment Loan (1990) and is currently devoting considerable efforts in coordinating international agencies with operations in Trinidad and Tobago. IDB, EC and, more recently, the CDB have been the key players in multilateral funding in Trinidad and Tobago (see appendix 1).

Net public flows from bilateral donors increased over the first half of the period, but have become insignificant since 1985, as shown in exhibit 7, because several agencies such as USAID, CIDA and DFID are no longer active in the country given that Trinidad and Tobago is no longer eligible for their assistance.

Allocation of Official Aid

Official aid in Trinidad and Tobago has been mainly used by the government to meet social investments needs, to alleviate poverty and to finance basic infrastructure. During this last three years major commitments from the multilateral organizations have been focused on health, education, environment, transport and poverty reduction. (See 1.4)

Private flows

Net private capital flows in Trinidad and Tobago have increased from just over US$342 million in 1970 to US$713 million in 1999 (real 1999 constant US$), as presented in exhibit 8. It appears that foreign direct investment has driven most of the growth in net private capital flows over the 90s. The investment needs in the Tourism and Energy sector have been the main drivers of foreign direct investment accounting for more of US$ 600 million in 1999.

Role of aid and its effectiveness

Official Aid in Trinidad and Tobago has played a relative small role in public finance over the past decade, averaging 1% of GDP in the last three decades (see exhibit 9). Aid has not been used to promote sustainable economic growth, but rather as a prop to public sector expenditures during and following economic downturns.

In addition, official aid was not sought due to the important private inflows that have represented on average seven times more than official flows in the past three decades (refer to exhibit 10). Trinidad and Tobago benefits from an important foreign investment in the Energy and Tourism sector.

BILATERAL DONOR DETAILS – NET ODA (US$M 1999)

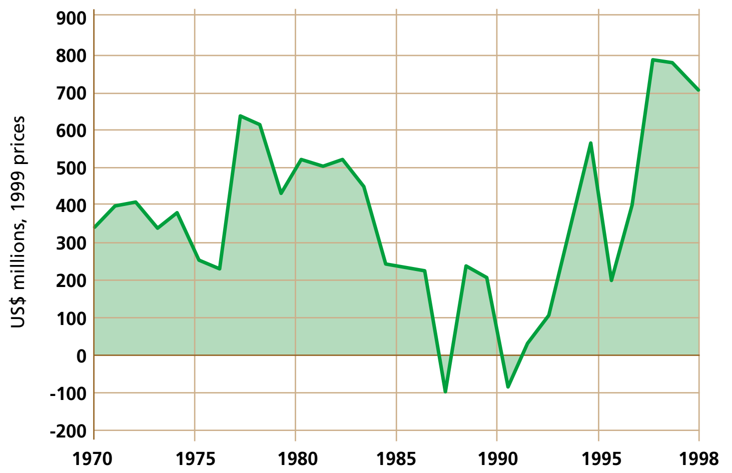
Exhibit: 7

	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
EU Members	7.53	2.46	-1.03	13.17	-3.11	-3.06
Japan	0.16	0.36	0.24	0.40	1.27	1.76
UK	6.28	1.81	-2.59	0.43	0.86	0.43
US	0.00	0.00	0.00	0.52	0.00	0.02
Other	3.34	1.11	0.67	0.77	1.02	0.50
Total	**17.30**	**5.75**	**-2.71**	**15.29**	**0.04**	**-0.35**

Source: OECD DAC online database

NET PRIVATE CAPITAL FLOWS IN TRINIDAD AND TOBAGO

Exhibit: 8



Source: OECD online database.

AID AS A PERCENTAGE OF GDP

Exhibit: 9

	1970	1975	1980	1984	1990	1995	2000
Aid (% of GDP)	0,5	0,5	2.2	0.5	1.5	1.8	-0.3

Source: OECD DAC online database

RATIO OF PRIVATE VERSUS OFFICIAL FLOWS

Exhibit: 10

	1970	1975	1980	1982	1984	1985	1991	1995	1997	1998	1999
Private/Official	10.7	8.2	2.1	70.0	4.1	20.0	1.3	5.9	11.6	3.7	-35.9

Source: OECD DAC online database

The largest multilateral lender in Trinidad and Tobago is the Inter-American Development Bank with a current loan portfolio of some US$ 600 million and a large local presence. However the Bank has only made one new loan in the past 4 years (for education) and presently loan repayments exceed loan disbursements. Social development related projects e.g. social housing, are the type of activities where it is active. On the other hand, The World Bank continues to provide advice to government, including sectoral studies, and some technical assistance. The other main multilateral lenders are the Caribbean Development Bank, mainly transport infrastructure and credit lines, and the European Investment Bank which has focused on assistance to small business development and, more recently micro-finance through Development Finance Limited (DFL), a successfully privatised former state owned development bank and its micro finance subsidiary, MicroFin (see appendix 2).

Given its level of development, as mentioned above Trinidad and Tobago has "graduated" from bilateral assistance from agencies such as USAID, CIDA and DFID. However, its small island status makes it still eligible for ODA under the umbrella of the UN agencies. As a signatory to the Lomé and Cotounu Conventions, it is also eligible for EU assistance and indeed the EC has the largest grant programme in the country (ongoing 20 million). Japan and China have also provided bilateral assistance.

All major lenders/donors reported problems with implementation notably due to weak project management capacity and procurement issues. In 2000, both IADB and WB rated 50% of their projects as being unsatisfactory. The EC Delegation reported that Trinidad and Tobago was among the ten out of 70 plus ACP countries eligible for financing under the Lomé Convention not to have qualified for the second tranche of funding, due to under-utilisation of the first tranche. Some 3 million unutilised under the agricultural credit facility is due to be cancelled later this year.

An effort to address these problems has been made by the government. In 1998, an Inter-Ministerial Committee chaired by the Prime Minister was established to resolve bottlenecks affecting project and programme implementation and to make line ministers more accountable for their programmes. Weaknesses in implementation capacity are recognised, but difficulties have been experienced in retaining qualified staff in PIUs once successfully trained.

From the country's perception, these problems are compounded by the practices of MFIs such as:

- Conditionality overload - greater selectivity needed in defining conditionalities with a closer regard for the political realities on the ground;
- Tendency towards a one-size / one-fit approach to programme design;
- Too little ownership of projects – dialogue on design begins too late;
- Lack of donor co-ordination;
- Lack of effective monitoring and supervision.

Similar remarks may apply to grant-funded programmes, in particular the failure to adequately monitor implementation and to take corrective actions in a timely way, in the knowledge that local capacity for implementation is weak. The EC was criticised for its lengthy decision-making processes and a lack of transparency in procedures.

Aid and NGOs in Trinidad and Tobago

The role of NGOs in the delivery of various social and welfare services to the poor, such as the provision of skills training and income and employment-generating projects has increased as government expenditure on social service programmes has declined in real terms. However, their overall effectiveness as providers of services is limited, with the exception of a few larger organisations, due to weaknesses in capacity and inefficiencies in programme targeting.

NGOs in Trinidad and Tobago have been mainly involved in development rather than advocacy as they are subjected to political interference and pressure as well as other bureaucratic obstacles.

Most of the NGOs are affiliated with the Ministry of Community Development and Gender Affairs or the Ministry of Social Development. There are also a number of smaller, church-based organisations. Many rely entirely on the government for financial and administrative assistance, restricting their independence and effectiveness. Many have been set up in order to attract funding from foreign donors – resulting in a proliferation of some 850 registered NGOs[39]. Services range from residential care for abandoned/abused children, shelter and care for abused women, day care for children and the elderly, vocational training for the disabled, drug rehabilitation and micro-finance.

The private sector does not have a well-defined relationship with the NGO community; however the relationship with some external donors appears to be better-defined and more productive. Nevertheless the legal framework under which NGOs operate is vague, resulting in accountability problems. In addition, a well-established agency, such as a national umbrella NGO to play a co-ordinating role, is lacking.

The ability to measure the effectiveness and efficiency of NGO performance in reducing poverty has been restricted by the absence of comprehensive and reliable data. The level of government and donor monitoring is insufficient and little effort has been made at ex-post evaluation of NGO poverty alleviation. It has been observed that NGOs, especially those dependent on government support, tend to be brought in at the implementation rather than the design stage, which has affected their effectiveness.

Most NGOs suffer a critical shortage of qualified permanent staff with basic skills such as bookkeeping, accounting and procurement. They operate under substantial financial constraints and in the absence of a clear regulatory and legal framework. In the view of the Ministry of Finance there is a lack of co-ordination between the NGOs themselves and the donors providing direct financing where that is the case. Efforts are required in the promotion of greater networking between NGOs – a surely achievable task given the size of the country, the strengthening of the capacity of NGOs, and, as proposed in a World Bank report, the establishment of an accreditation process for NGOs.

1.4 Poverty reduction

Although Trinidad and Tobago is classified as a middle-income country enjoying increasing rents from oil and gas, the government's Development Strategy has not been successful in transferring these benefits to the least advantaged.

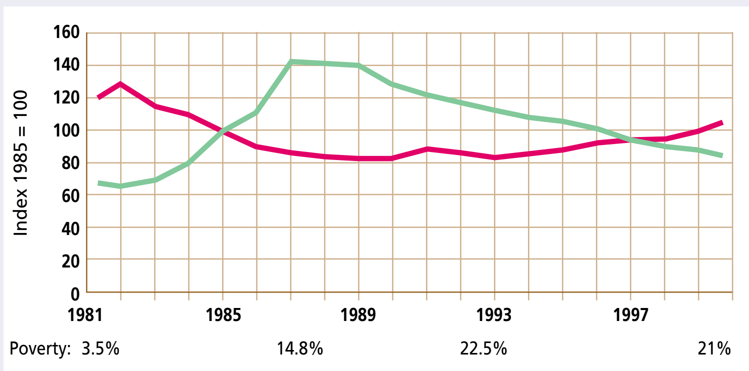
As can be seen in exhibit 11, more than 21% of the population still live below the national poverty line, a level which has remained little-changed over the past ten years. Increases in poverty in Trinidad and Tobago have been closely linked with downturns in the economy (oil prices decreases) and the subsequent rise of unemployment. During the period of economic decline (1981-1993), unemployment increased significantly, swelling the poor population. During this period absolute poverty increased from 3.5% of households in 1981 to 14.8% of households in 1988[40].

During the reform period macroeconomic measures were adopted. The combined effects of retrenchment in the public sector and a decline in the real value of social sector spending resulted in a decline of living standards for the low-income groups of the population. One estimate of poverty indicated an increase from 18.5% of households in 1988 to 22.5% in 1992[41], with further widening in the distribution income.

In 1999, the World Bank estimated that one in five persons lived below the poverty line, defined as being TT$2,420

TRENDS IN GDP PER CAPITA AND UNEMPLOYMENT

Exhibit: 11



Source: World Bank, IMF and Ministry of Finance in Trinidad and Tobago

39 For example the IADB-financed Community Development Fund
40 See Teekens, R. " Poverty data from two family budget surveys in Trinidad and Tobago, 1989.
41 Henry and Melville, 1989

(US$384) per annum. The term 'new poor' has come to include those who are active in the labour force but subsisting at low wages and almost 11% of the population are in extreme poverty with consumption levels below the minimum required to purchase the nutritionally balanced low-cost food basket.

Poverty in Trinidad and Tobago is associated with unemployment (14%) and also with underemployment (5%), particularly affecting the youth and women. Approximately 31% of the youth are unemployed and poverty among women, who head one third of poor households, is 30% higher than for men. Poverty is evenly divided between rural and urban areas, although the incidence of poverty is higher in the St. Andrews and St. George counties. One of the challenges facing the government over the next decade is to reduce poverty from the current 21% to 12% by end-2009.

Social Indicators

Despite the increase in poverty, most social indicators have progressed in Trinidad and Tobago due to improvements in infrastructure of basic services. The infant mortality rate has declined from 45‰ births to 16‰ over 1975-1999 (see exhibit 12). However, the birth rate declined from 28 births per thousand to 15 in the same period, while the death rate remained at 7‰. The declining birth rate is evident in the primary and secondary school (gross) enrolment rates. Primary school enrolment fell from 113% in 1975 to 98.2% in 1995, while the secondary school enrolment rate increased from 1975 to 1985, with some retrenchment in 1995. The adult illiteracy rate has halved over the same period.

Trinidad and Tobago's relative performance compared with similar MDCs

For the most part, social indicators of development in Trinidad and Tobago are better than those for the region and for the upper middle-income countries as a whole (see exhibit 13). Trinidad and Tobago outranks Latin America on most indicators. The exceptions occur with regards to primary school enrolment rates, but as noted above this may be more indicative of changes in the rate of natural increase over time rather than as a measure of underdevelopment.

SOCIAL INDICATORS IN TRINIDAD AND TOBAGO

Exhibit: 12

	1975	1985	1995	1999
Infant mortality rate (per 1,000)	44.6	25.6	15.0	15.7
Life expectancy at birth (in years)	66.6	69.7	72.3	72.6
Primary school enrolment rate (in %)	112.9	96.1	98.2	n.a.
Secondary school enrolment rate (in %)	48.3	81	73.9	n.a.
Adult illiteracy rate (in %)	13.7	9.8	7.3	6.5

Source: Compiled from World Bank Development Indicators, various

COMPARATIVE PERFORMANCE, 2000

Exhibit: 13

	Trinidad and Tobago	LAC	Upper middle income countries
Population (million)	1.3	516	647
GNI (Atlas method, US$ billion)	6.4	1,895	2,986
GNI per capita (atlas, US$)	4,930	3,680	4,620
Poverty (% population below national poverty line)	21	n.a.	n.a.
Urban population (% of total)	74	75	76
Infant mortality rate (per 1,000)	16	30	20
Life expectancy (years)	73	70	69
Access to improve water source (% of population)	86	85	87
Adult illiteracy rate (% of population)	6	12	10
Gross primary enrolment (% school age population)	99	113	107

Source: World Bank

2. INSTITUTIONAL INFRASTRUCTURE

2.1 Political System
(Overall rating 4)

Since independence, the Constitution of Trinidad and Tobago has provided an effective basis for the exercise of political power through democratic processes. However increasing polarisation of the main parties along ethnic lines over the past 15 years has increased the risks of cronyism and patronage[42].

2.1.1 The Rules

Trinidad and Tobago owns a constitution still embedded in the Westminster model, which was promulgated after the country became a Republic. When Trinidad and Tobago became independent in 1962 the foundations of the modern state were already laid, drawing extensively on the institutional structure and practice developed under the British administration.

The new constitution in 1976 removed the British monarchy as head of state, creating a presidential-led Republic. Trinidad and Tobago has continued to remain part of the Commonwealth. This constitution established the office of President, elected by a majority of both houses of Parliament, replacing the former governor-general. The President is elected for a five-year term through a specially-constituted electoral college that comprises members of the Senate and the House of Representatives.

Executive authority remained vested in the Prime Minister who is the head of the ruling party. The bicameral parliament consists of a 36-member House of Representatives elected for a five-year

42 Trinidad became a British colony in 1802 under the Treaty of Amiens and Tobago in 1814 by the Treaty of Paris, becoming administered as one colony in 1890. The abolition of slavery was enacted in Britain in 1838 and had an immediate impact on the economy of the plantations. To make up for the shortfall in agricultural labour, Indians began to arrive in Trinidad from 1845, as indentured labourers from both the Muslim and Hindu regions of the country. In total some 144,000 are estimated to have "immigrated" up until 1917. Ethnic Chinese and Portuguese also came as indentured labourers in lesser numbers from the island of Madeira. Finally traders from the Levant also settled helping to make Trinidad and Tobago the cosmopolitan society it is today.
According to a recent survey of the Central Statistical Office, the ethnic make-up of Trinidad and Tobago is presently as shown in the box opposite.

Ethnic group	% of population (1999 census)
African descent	39.6
East Indian Descent	40.3
Mixed	18.4
Caucasian	0.6
Chinese	0.4
Other	0.2
Not stated	0.5
	100.0

Source: Central Statistical Office, Trinidad and Tobago

Although Trinidad and Tobago has not experienced significant social tensions as a result of its ethnic composition, since independence political parties have sought to exploit ethnic constituencies with negative consequences for the practice of good government.

term and a 31-member senate, with 25 senators appointed by the Prime Minister and six by the opposition. The Prime Minister, who has the power to dissolve the parliament at any time, selects 16 senators, while nine are appointed by the President and six by the leader of the opposition. The 36-seat House of Representatives are voted in by the electorate.

Universal adult suffrage was introduced in 1946, coinciding with the development of political parties, of which the Peoples National Movement (PNM), led by Oxford-educated historian Eric Williams until his death in 1981, was the most significant. Electoral participation has been historically high. In the hard-fought national elections of December 2000, 76% of the eligible voters cast ballots and participation by young people was particularly high. The early election called in December 2001 attracted a further high turn-out but resulted in a political gridlock which took many months to resolve.

Devolution of power is also limited. Tobago has a House Assembly, comprising a 12-member elected body. It has limited tax-collecting powers, but has some autonomy over health, education, housing and administrative issues. However the complaint is frequently heard that Tobago does not receive its fair share of the national budget. Trinidad has 14 regional bodies, with limited responsibilities and funding.

2.1.2 The Structure

The first past the post system, combined with a 36 seat House of Representatives has resulted in an 18/18 tie in 2001 and the risk that a further election could produce the same result. In order to understand the process through which this situation has come about, a brief account of post-independence political history is necessary. The People's National Movement (PNM) ruled the country for 30 years continuously until 1986 and was dominated by individuals of African descent. Having been deprived of its leader five years previously, and in the midst of an economic slump linked to the collapse of oil revenues, the party was soundly defeated by the National Alliance for Reconstruction (NAR), a coalition that attempted to bridge the African/East Indian political divide, led by Arthur Robinson (later to become President). Support for the NAR declined swiftly in the face of Mr Robinson's autocratic style and 'austere IMF-supported economic reform programmes'. The coalition unravelled when Basdeo Panday was expelled and formed the East Indian-based United National Congress party.

In July 1991, a radical black Muslim group briefly seized parliament but were quickly ousted. In December of that year, Patrick Manning, who had taken over leadership of the PNM, led the party to victory. His government continued deregulating the economy and floated the currency, but the social consequences of these reforms (rising unemployment and poverty) cost the government support. The PNM and UNC won 17 seats each, with voting again running along largely ethnic lines, but the NAR held two seats in Tobago and entered in to a coalition with the UNC in exchange for a ministerial post for Mr Robinson and a promise of greater autonomy for Tobago. Basdeo Panday thus became the county's first Prime Minister of East Indian descent. In 1996 Mr Robinson was elected President.

The UNC was considered to be the more liberal party in terms of its management of the economy. Indeed the economy experienced sustained GDP growth, low inflation and declining unemployment as well as a significant increase in foreign investment in the energy sector. However as its term in office progressed there were increasing allegations about sweetheart contracts and corruption. Nonetheless, on the strength of the positive economic situation, in the December 2000 elections the UNC had a majority of 19 seats to the PNM's 16, with the NAR winning one of the two seats on the island of Tobago. The election was mired by accusations of malpractice and the swearing-in ceremony was delayed by nine days due to recounts in several constituencies and a threat of legal action by the PNM. President Robinson refused to swear in six nominees to Panday's cabinet who had been defeated in the election saying that such appointments "undermined democracy".

The PNM also challenged the eligibility of two successful UNC candidates holding dual nationality in the Courts. This triggered the last elections in December 2001 which resulted in an 18/18 tie between the two main parties. The leader of the opposition was invited to form a government of "national unity" by the President. Having failed to agree on a power-sharing arrangement, the PNM formed a single party government, with the UNC effectively boycotting Parliament.

In the present situation, a further election which the PNM has so far refused to contemplate could result in another stalemate. Given the personal antipathy between the main party leaders and the deliberate policy of both parties to appeal to ethnic constituencies, an immediate resolution is difficult to envisage. Equally, in the present situation it is as difficult to see constitutional reform being feasible. If no compromise is found a new election will have to be called at the latest in October of this year when a new national budget would have to be voted for the government to remain in business. Failing constitutional reform, the emergence of a new independent party with an appeal over-riding the ethnic divide would appear to be the only way out of the present impasse in which the politics of the country now finds itself.

2.1.3 Management

Since independence, the government has been heavily influenced by a few individuals who have marked the politics of Trinidad and Tobago. Despite a working democratic constitution, the political system has become increasingly tainted with allegations of corruption and patronage, both of which appear to have some basis of fact.

The risk of political interferences is heightened by weaknesses at the executive level. Although efforts were made to slim down public administration as part of the economic reform programme, insufficient attention was paid to upgrading its quality. Civil service remuneration has fallen far behind that of the private sector, making the retention of talent increasingly difficult and increasing the risk of susceptibility to paybacks. Political and personal interests also influence appointments in the public sector. For example, the present administration has created a number of new ministerial posts and the chairmen and boards of a number of public companies have been replaced since it assumed office.

Meanwhile the present administration is conducting investigations in to alleged malpractice under the previous UNC government. Allegations of corruption have still to be proven, yet there have been widely-articulated concerns regarding the contracting of a number of major public works, including the new terminal building at Piarco Airport, highway construction contracts and school buildings to mention but three examples widely publicised in the press.

The management of the political system is characterised by a slow decision-making process caused by the bureaucracy. An inordinate number of decisions are taken at Cabinet level. An example was provided by the Ministry of Planning and Development, where it was ascertained that a typical FMI-funded project might go up to Cabinet level at six different stages during the project cycle. This also allows opportunities for political interference at the technical level. A couple of cases were identified in which projects put forward to the EIB for financing "disappeared" at Cabinet level after full appraisal had been completed.

Whilst the government has developed medium-term policy frameworks and has formulated a seven-year national development strategy, it faces implementation problems. The two Ministries involved in development assistance are the Ministry of Finance and the Ministry of Planning and Development. Both Ministries suffer from an exodus of best-qualified talent and therefore a shortage of management capabilities, as mentioned above. This lack of institutional effectiveness has translated in to inefficiencies in the implementation of public administration strategy, at both national and local levels. This issue is recognised by the government, donors and the private sector and may be exacerbated by the present political stalemate.

2.2 Legal Framework
(Overall rating 4)

The country inherited a legal system and structure based on the British system (the Privy Court in London remains the instance of final appeal). Recent legislation has also drawn on best practice from North America (e.g. the Companies Act 1995). Progress has been made in the past three years in improving the operation of the court system, although much remains to be achieved in the processing of civil cases.

2.2.1 The Rules

The law of Trinidad and Tobago is based on the common law of England. Decisions of the Privy Council are binding on the lower courts. The principles derived from the decisions of the courts of the United Kingdom and other Commonwealth countries, particularly Australia, New Zealand and Canada, though not strictly binding, are applied. A growing body of local jurisprudence is also evolving.

Laws in Trinidad and Tobago provide an effective and stable basis for the settling of disputes in commercial cases. While delays caused a considerable problem in the past, efforts made to tackle the backlog of cases and to encourage alternative methods of settlement have been successful in recent years. The situation is far less positive regarding the application of criminal law processes, mainly due to an inadequate and incentive system and a lack of facilities.

2.2.2. The Structure

The Supreme Court is the highest Court in the land, comprising the Court of Appeal and the High Court of Justice. The judiciary is independent, although subject to some political pressure. The Chief Justice is appointed by the Prime Minister for a five-year term. Judges are appointed by the Judicial and Legal Services Commission, and other appointments are also made by independent commissions.

The judiciary comprises a Supreme Court and District Courts. The Supreme Court consists of the High Court of Justice and ten puisne (subordinate) judges. The District Courts are presided over by a Chief Magistrate and seven senior and 18 stipendiary magistrates. In these courts the work of the Petty Civil courts and the courts of summary jurisdiction is conducted.

Unless compromised, commercial disputes that go to court are heard and determined by the Supreme Court. There is a three-tier system. In the High Court, all civil trials are determined by a single judge without a jury. From the High Court a party can appeal as of right to the Court of Appeal, which sits with three judges. The Judicial Committee of the Privy Council in London still serves as the recourse of ultimate appeal. Plans are however underway to establish a Caribbean Court, which would replace the Privy Council as the highest court of appeal for criminal matters.

The Attorney General is responsible for the administration of legal affairs. Legal proceedings for and against the State must be taken in the name of the Attorney General in cases of civil proceedings and in the name of the state in the case of criminal proceedings. The Attorney General has responsibility for the Departments of Civil Law, Criminal Law, Legislative Drafting, Registrar General and General Administration which are headed by the Solicitor General, the Director of Public Prosecutions, the Chief of Parliamentary Counsel, the Registrar General and the Permanent Secretary respectively.

The Civil Law Department includes the Chief State Solicitor's Department, which is headed by the Chief State Solicitor. The Registrar General's Department includes the Civil Registry, the Land Registry, the Companies Registry, the Intellectual Property Office and the Legal Aid and Advisory Services.

The Registrar's General Department and the Land Registry are both considered to be in need of reform as part of a wider programme to address land tenure reform and land titling.

2.2.3 Management

The judiciary system in Trinidad and Tobago delivers efficient services in commercial cases; while criminal cases lack an incentives system and basic infrastructure.

In 1999 a World Bank report outlined that the judiciary system in Trinidad and Tobago was not meeting the increasing demands of the private/public sector for contract enforcement and dispute resolution. Since then there have been significant improvements, particularly in the commercial courts regarding the quality of jurisprudence, the delays in having matters determined and in the workings of the trial system. For example, in commercial matters it is now the norm to see a trial date fixed within two years, whereas previously delays of up to six years were not uncommon. The efforts of the skilled and qualified Chief of Justice together with external assistance have enabled Trinidad and Tobago to achieve these improvements.

Concerning civil cases, according to a 2001 Report from Freedom in the World the increase in criminality has led to a backlog of the court system up to five years, with an estimated 20,000 criminal cases awaiting trial. Prisons are grossly overcrowded; and more than 100 prisoners are on death row. Despite efforts to tighten controls, the country remains an important transhipment point for cocaine and an estimated 80% of crimes are believed to be drug-related. The death penalty was reintroduced in a recent major drug-related case.

Corruption in the police force, where low levels of remuneration are a contributory factor, is acknowledged to be a problem. Law enforcement inefficiency also results in the dismissal of some criminal cases. The previous government had received some recognition for its anti-drug efforts and was a principal proponent of a regional witness-protection programme.

2.3 Financial System
(Overall rating 5)

Trinidad and Tobago has developed a sound financial sector, operating within an appropriate regulatory framework. Progress is being made towards a consolidated supervision of financial institutions. However, further deepening of the capital market would be desirable, including the development of private pensions.

2.3.1 The Rules

An independent central bank regulates the operations of commercial banks and other financial institutions and determines monetary policy. The Central Bank of Trinidad and Tobago was established in 1964 by the Central Bank Act (Act No 23 of 1964). This Act was amended on several occasions, the most recent of which was the Central Bank Amendment Act of 1994. The main provision was to entrust the Bank with monetary, credit and exchange policies. The Central Bank is also empowered under the Financial Institutions Act 1993 to grant or revoke licenses, recommend regulations, issue cease and desist orders, prescribe the qualifications of the management and directors of financial institutions and generally to ensure the prudent operations of financial institutions in the public interest.

The Central Bank exercises supervisory responsibility for the six commercial banks and 15 non-banking financial institutions operating in the country. Under new legislation under preparation, its supervisory powers would be extended to the pensions and insurance industries.

It has provided guidelines regarding the detection of money laundering which have been incorporated in to the Proceeds of Crime Act. The commercial banks themselves have also developed and subscribed to a rigorous code of best practice regarding the handling of suspicious transactions. Notwithstanding its reputation as being an important transit route for narcotics, Trinidad and Tobago appears to have been successful in avoiding financial contamination connected with money laundering.

2.3.2 The Structure

Trinidad and Tobago has a small but diversified financial system. The Central Bank is independently managed and administered by a Board comprising the Governor, two Deputy Governors, five Directors, two of which are appointed by the Ministries of Finance and Planning and Development. The Governor is the Chairman of the Board and is responsible for the day-to-day management of the Bank. He is appointed by the President upon recommendation of the Prime Minister for a five-year term. The Bank presently has some 450 employees.

The consolidation of the banking system as of 1996 has resulted in the emergence of six commercial banks. The largest, Royal Bank, accounts for approximately 28% of total bank assets. The one publicly owned bank, First Citizens Bank, was established to rescue three ailing banks. It accounts for less than 10% of the market and is being prepared for privatisation. Only one new bank has entered the market in the last five years – Inter-Commercial Bank, established in 1998 as a subsidiary of the ISPAD Group. There are approximately 130 bank branches throughout the two islands.

Evidence of breadth as well as depth of the financial sector is given by the existence of trust companies, merchant banks, finance houses, mortgage finance institutions, mutual funds including a unit trust corporation, a secondary mortgage company and more than 30 insurance companies.

Since 1996, there has been a large increase in credit unions, and a supervisory body was set up in February 2000 to oversee their activities. The Agricultural Development Bank and FundAid provide long-term finance for small farmers and businesses respectively, but are dependent on government subsidies. Of note is a commercially based provider of micro-finance, MicroFin, which was established in 1999 upon the initiative of Development Finance Limited.

In carrying out its mandate, the Central Bank has fostered the development of a number of financial institutions with a view to strengthening the local money and capital markets. These include the Trinidad and Tobago Stock Exchange, established in 1981 (succeeding the call exchange set up in 1965), and the Deposit Insurance Corporation which was started in 1986.

Further information on the structure and main characteristics of the financial system is given in appendix 3.

2.3.3 Management

The financial system is both well managed and regulated and has avoided the contamination that has affected those of certain neighbouring jurisdictions.

The Central Bank

The Central Bank has established itself as a mature and independent regulatory institution, which is widely respected in the financial community. It has nonetheless continued to take advantage of external assistance programmes to strengthen its capabilities in core areas such as supervision (WB and IADB-financed).

Financial sector

Generally the financial sector has benefited from limited state presence and a progressive transfer of good practice. At independence the only commercial banks operating in the country were in fact branches or regional offices of multinational banks (mainly Canadian and British). The Royal Bank of Canada, for example had its Eastern Caribbean regional office in Trinidad. The management and senior staff was a combination of local and expatriate staff resulting in a fusion of local knowledge and international best practice.

In the early 70s, rather than nationalizing, the government encouraged what was termed localisation. Banks should incorporate their local branches forming legal entities onshore. Shares in the newly-incorporated banks were offered on the stock market and gradual ownership and management transfer was achieved. In the case of the Royal Bank of Canada this process was concluded in 1982 when 75% of the remaining shares of RBC were acquired by management as an ESOP, and the remaining 10 % were again offered on the local market.

Several of the commercial banks have expanded their offices regionally not least to service larger clients whose own activities are regional. Royal Bank a presence in St Vincent, St Kitts and Nevis, St Lucia and Grenada, and has recently acquired ABN Amro's operations in St Martin and Surinam.

There has been little public sector involvement in this sector. Development Finance Limited was established shortly after independence to provide long-term finance to promote industrial development. Following years of mismanagement it was privatised in 1987, and successfully turned around to become a major player not only in Trinidad but also in the sub-region. By way of contrast, the small Agricultural Development Bank remains under state ownership, providing seasonal credit and investment loans to small farmers. Like similar institutions around the world, it has been plagued by poor management and a high level of non-performing loans.

The spread of between 7-12 percentage points between deposit and lending rates raises concern about competition in the banking sector (see exhibit 14).

Reserve requirements on banks are 21% on domestic currency deposits and 9% for non-banks. There are no reserve requirements for foreign currency deposits. The tight monetary policy and the high reserve requirements have kept lending rates high (prime rate about 17.5%) and the spread at about 10%. Moreover, the spread on lending rates in local currency is more than twice the spread on foreign currency rates. The increasing spread since 1998 for domestic currency reflects increased off-budget borrowing by the central government. The low spread on foreign currency is partly explained by the fact that lending is almost exclusively to corporate borrowers with foreign exchange earning capacity.

The ratio of bank assets to GDP has advanced more or less in line with the ratio of M2 to GDP, as illustrated in exhibit 15. From 1991 however, bank assets to GDP outpaced the ratio of M2 to GDP. An IDB report on the domestic economy states that excess liquidity and prudent monetary policy characterize the monetary sector in Trinidad and Tobago. An increasing tendency by investors to hold other assets, such as foreign currency deposits with commercial banks[43] should feed through to a declining ratio of narrow money to output.

Non-performing loans in 2000 represented 4.7% of the total loan portfolio, down from 7.5% at end 1997. The financial system is being strengthened with support from the WB and IADB.

Changes to broaden the securities market have recently been instituted by the Central Bank with the introduction of open market treasury bills and notes as additional policy instruments. These market-based instruments have reduced

43 Foreign currency deposits increased from 6% of GDP at the end of 1995 to approximately 10% in 2000 (IADB, 2001).

WEIGHTED AVERAGE INTEREST RATES ON COMMERCIAL BANK LOANS AND DEPOSITS

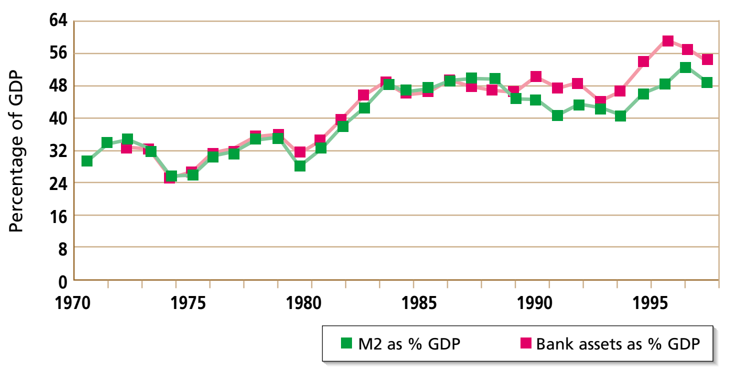
Exhibit: 14

	1997	1998				1999				2000	
	IV	I	II	III	IV	I	II	III	IV	I	II
	Local Currency										
Loans	13.35	14.45	15.16	15.57	15.56	15.82	15.95	16.20	15.71	15.21	15.18
Deposits	5.49	5.86	6.23	6.41	6.54	6.56	6.37	5.93	6.08	6.06	6.03
Spread	*7.86*	*8.59*	*8.93*	*9.15*	*9.02*	*9.26*	*9.58*	*10.27*	*9.63*	*9.14*	*9.15*
	Foreign Currency										
Loans	9.89	9.76	9.86	9.84	9.76	9.76	9.74	9.98	10.06	10.26	9.45
Deposits	5.02	5.10	5.44	5.22	5.17	4.97	4.95	5.73	5.10	4.99	5.54
Spread	*4.87*	*4.66*	*4.42*	*4.62*	*3.98*	*4.79*	*4.79*	*4.25*	*4.96*	*5.26*	*3.91*

Source: IADB

FINANCIAL DEPTH IN TRINIDAD AND TOBAGO

Exhibit: 15



Source: Compiled from International Financial Statistics (IMF, various)

the excessive reliance on instruments such as reserve requirements to promote the stability of the financial system.

The Trinidad and Tobago Stock Exchange indices and volumes include four companies also listed in Jamaica and Barbados, with their primary operations listed in those countries. The Stock Exchanges of Trinidad and Tobago, Jamaica, Barbados, Dominican Republic and the Bahamas have entered in to an agreement for the harmonisation of the regional capital markets. The project, funded by the IADB, will examine and seek to improve the regulation, trading and clearance and settlement procedures in the region.

The mandate and structure of the Deposit and Insurance Corporation would require improvement. The private pension provision should also be revisited in the framework of a broader review of pension system which is now overdue.

2.4 Corporate Governance *(Overall rating 4)*

Efforts have been made in the realm of public sector reform, but with only partial implementation in some areas. In the private sector, reforms have gone deeper but some gaps remain.

2.4.1 The Rules

Although rules have been established defining the Principles of Corporate Governance, there are shortcomings in both their coverage and application. The powers and responsibilities of the Auditor General's Office are defined in the Exchequer and Audit Act. The Integrity in Public Life Act sets rules for the public sector, but its practice has lagged behind. One of the leading accounting firms has been commissioned to draw up a corporate governance code for the public sector.

In the private sector, the Companies Act, which was extensively up-dated and revised in 1995, and the Securities Industries Act of 1997, incorporate North American and British best practice. The new Companies Act, which was influenced by Canadian practice, offers better protection for shareholders and minorities than the legislation it replaced[44]. International Accounting Standards are widely adhered to, and a number of international accounting firms have established offices providing both auditing and business consulting services. Trinidad and Tobago has investment grade ratings from both Standard & Poor's (S&P) and Moody's. Notwithstanding the present political impasse, S&P recently (February 2002) increased its rating from stable to positive, citing "an improved economic structure, which in turn underpins growth prospects within and outside the energy sector".

2.4.2 The Structure

The Auditor-General's Office has overall responsibility for ensuring standards of corporate governance. Some weaknesses however still need to be addressed. The legal and regulatory frameworks for good corporate governance in the private sector are in place as are the professional bodies to ensure their application. The Auditor General is appointed by the President and reports to the House of Representatives and the Ministry of Finance. The Attorney General has the dual role of acting both as a member of government in the performance of certain duties and as guardian of public interest. The former Attorney General pursued a strong reform agenda, addressing in particular public procurement and financial management. However this led to divisions within the then-ruling party and the resignation of the Attorney General, which in turn helped precipitate the 2001 election. As mentioned in 2.1.3 above, transparency in public contracting, public accountability and financial management still show weaknesses.

Trinidad and Tobago has well-developed accounting and legal professions, many of whose leading practitioners having been trained in the United Kingdom and Canada.

2.4.3 Management

Public sector

The Auditor General's Office is responsible for the audit of all public funds, including that of state enterprises. This includes the audit of all donor-funded projects in the public sector. According to its powers as defined by the Act, the Office is responsible only for the financial veracity of the accounts audited. However, the Office may be asked specifically to carry out management or performance audits. Reports and recommendations are sent to the Public Accounts Committee and Public Enterprise Committee of the House of Representatives and to the Ministry of Finance.

The Office is well managed but under-resourced. It has no powers of enforcement and its recommendations are often ignored or filed without action. Under a new Audit Act, which is being drafted and could be approved during

44 Based on an interview with the Vice President of the American Chamber of Commerce of Trinidad and Tobago.

2003, the powers of the Office could be extended to include performance auditing and more comprehensive audits. It would also empower the Auditor General to send reports directly to the Director of Public Prosecutions when evidence of abuse of office or financial malpractice is identified.

A lack of resources allocated towards monitoring and a failure to ensure adequate maintenance provision for projects are two mismanagements commented by the Office with respect to donor-funded projects which it has audited.

Private sector

All companies must be registered in accordance with the requirements of the Companies Act, either by way of incorporation of a local company, or through the registration of a foreign-owned company. Incorporation and registration fall under the authority of the Registrar General who is the Register of Companies. The Registrar General falls under the responsibility of the Ministry of Legal Affairs whose portfolio also includes intellectual property and consumer affairs. According to one leading law firm, company registration is a fairly routine matter. Once the corporate name has been approved the process may take up to ten working days.

Once registered, companies are liable to corporation tax and a business levy, value added tax (15%) and National Insurance Service contributions for employees. Tax collection and accounting is handled in a fair and transparent way.

The Companies Act also requires annual audits of companies' financial statements. Public companies are required to file copies of financial statements with the Registrar General and such statements are available for public inspection. Public companies are also required to have an audit committee comprising at least three directors of the company, the majority of such directors not being officers of the company or its affiliates.

Although corporate governance has developed from, and still refers to, UK best practice, its application is subject to cultural differences and gaps must still be filled. For example, there is no takeover code, and legislation on disclosure remains inadequate.

Overall, recent governance indicators suggest a decline in performance except for Regulatory Quality and Government Effectiveness between 2000/01 with 1997/98 (see exhibit 16 below).

2.5 Trade and Competition
(Overall rating 4)

Given the small size of the local market and its strategic position between Latin America and North America, there have been strong incentives for the opening of the economy to trade and competition as liberalisation began in the late 80s. Like other small market economies, Trinidad and Tobago has needed to establish new trade and economic linkages to maintain competitiveness.

2.5.1 The Rules

Until the late 80s, the trade regime in Trinidad and Tobago was restrictive and non-transparent, characterised by high tariff protection, widespread use of quantitative restrictions and heavily regulated foreign exchange markets. The regime relied on import-substitution based industrialization as recourse to protectionism in the face of external shocks (IMF, 1999).

The structural adjustment program introduced after the balance of payments crisis in the late 80s helped to introduce a gradual relaxation of import prohibitions and licenses on many intra and extra-regional imports, a relaxation of exchange control barriers and a major rationalisation of the tariff structure.

By 1990, the imports of 12 product groups, accounting for over 37% of total imports were freed from exchange controls, raising the share of imports free of exchange controls to more than 60%. Trade liberalization, further accelerated over the 1992-1998 period, now covers all imports. Exports are free of any restriction, subject to the usual requirements of submission of invoices, shipping documents and freight charges to the customs authorities.

The Foreign Investment Act, passed in 1990, facilitated the acquisition of interests in land or shares in local private or public companies and for the formation of new companies by foreign investors. However, the acquisition of more than 30% of the share capital in a publicly-owned company and more than five acres of land for trade purposes requires the issue of a licence.

Intellectual Property legislation covering patents, trademarks and protection against unfair competition has been enacted since 1995, and an Intellectual Property Office was created in 1997. Amendments to the Patents Act and Intellectual Property Act were passed in 2000.

Trinidad and Tobago had a fixed exchange regime until 1993. The exchange rate system was fully liberalised thereafter. Companies and individuals may hold foreign currency deposit and current accounts, and financial institutions are allowed to grant foreign currency loans. However there remains a liability to pay withholding tax where applicable.

2.5.2 The Structure

The Ministry of Trade and Industry is primarily responsible for overseeing trade and competition. Responsibility for supervising competition policy and anti-dumping falls under the aegis of this Ministry. The Ministry has full ownership of the following agencies for trade promotion: Export-Import Bank of Trinidad and Tobago, the Tourism and Development Company (TIDCO) and the Trinidad and Tobago Free Zones Company as well as majority holdings in the Point Lisas Industrial Port Development Corporation and the Trinidad and Tobago Export Trading Company. The Customs and Excise Division operates under the control of the Ministry of Finance.

The Manufacturers Association of Trinidad and Tobago and other business associations constitute pressure groups of which the government has to take notice.

Trinidad and Tobago has been a GATT contracting party since 1962, and is a WTO member since 1995. It is a founding member of CARICOM and the hosts the headquarters of the Association of Caribbean States.

2.5.3 Management

Since the early 90s, governments formed by both major parties have shown a full commitment to the attainment of a

GOVERNANCE INDICATORS FOR TRINIDAD & TOBAGO, 1997/98 AND 2000/01

Exhibit: 16

Governance Indicator	Year	Percentile Rank* (0-100), in %	Estimate (-2.5 to + 2.5)	Standard Deviation	Number of surveys/ polls
Voice and Accountability	2000/01	69.5	+0.61	0.25	4
	1997/98	77.6	+0.95	0.25	3
Political Stability /NoViolence	2000/01	58.0	+0.27	0.32	4
	1997/98	62.2	+0.32	0.34	2
Government Effectiveness	2000/01	74.4	+0.62	0.25	4
	1997/98	73.2	+0.52	0.37	2
Regulatory Quality	2000/01	84.0	+0.86	0.44	4
	1997/98	79.6	+0.72	0.52	2
Rule of Law	2000/01	66.5	+0.41	0.25	5
	1997/98	69.5	+0.51	0.31	3
Control of Corruption	2000/01	72.7	+0.49	0.26	4
	1997/98	75.0	+0.51	0.30	2

Source: Kaufmann, Kraay and Zoido (KKZ).2002: Governance Matters II: Updated Governance Indicators for 2000-01 market-driven economy and have taken steps to revamp the legal and regulatory framework to encourage foreign and local investors.

In 1999, the government initiated actions to overhaul the current investment incentives and approval processes. In 2000, the Tourism Development Act was passed to provide additional incentives for the development of this industry. Generally, Trinidad and Tobago now offers an attractive environment for foreign direct investment as the progressive diversification of its manufacturing and service base illustrates[45]. The fiscal, regulatory and legal environment support foreign direct investment. More than 130 international companies are now established on the islands.

Whilst the mission of TIDCO (established in 1995) was to be a "one stop shop" for investors, it has not been adequately resourced to fulfil this role. On the other hand, being an organisation not immune to political influence it has been used for "extraneous activities" such as for example the implementation agency for a donor-funded road construction project. Notwithstanding the country's small size, its openness and quality of professional services are such that the relative failure of TIDCO is not seen to have been an impediment to FDI.

Still, a number of issues remain to be addressed:

- The requirement to reform the Customs and Exercise Department, which still has a reputation for corruption and malpractice, notwithstanding the modernisation programme undertaken with the assistance of advisors from the United States Customs Service. An automated system (ASYCUDA) for the processing of export documentation through direct trader input was plagued by technical problems and the system has reverted to manual operation.
- The lax application of anti-dumping regulations, a concern expressed by local manufacturers.
- Issue was taken against the ease with which second-hand goods can be imported, from motor vehicles to apparel.

3. CONCLUSIONS

Official aid, whether OOF or ODA, has played a rather minor role in the country's development, at least in terms of physical infrastructure. During the past decade, the government has been able to rely on increasing economic rents from the oil and gas sector to finance a significant proportion of the public sector investment programme. As pointed out in the World Bank's 1999 Gas Study, the former can and should be further enhanced by revising the favourable tax and incentive regimes and the production sharing arrangements agreed in the past to attract the multinationals. Significant new finds which will soon move in to production will again grow the share of energy revenues in GDP over the next decade.

The country inherited a robust institutional structure serving as a platform from which to develop. Judicious use of advice and technical assistance provided by donors has contributed to further modernising the country's institutions and liberalising the economy. Whilst gaps remain, Trinidad and Tobago provides a good example of how developing its institutional infrastructure has helped overcome some of its potential disadvantages in terms of size and ethnic diversity, attract inward investment and diversify its economy. It has achieved the status as characterised by the World Bank of "a vibrant manufacturing and business centre providing financial and commercial services" with "a potential to broaden its economic base in tourism, and financial and information services, construction and entertainment services"[46].

Yet, infrastructure bottlenecks resulting from inefficiencies in the public administration have hindered private sector activity. Our analysis, and that of those directly involved in the implementation of external assistance, has shown poor implementation capabilities and political interference to have been critical factors in the failure to successfully implement major public sector investments. The former are due to the fact that whilst efforts have been made to reduce employment in the public sector, remuneration has fallen so far behind that of the private sector that retrenchment has also affected the ability to manage institutions efficiently.

Increasing human capital through investment in programmes in education, health and public service remains critical in order for the government to meet its poverty alleviation objectives and to address problems of social exclusion, which have become more acute in recent years. Greater recognition of the management failures which have handicapped implementation is thus required as well as the political will to address issues such as poor procurement practices. Donors will need to work more closely with the government and each other to improve programme design and implementation.

Failure to address poverty issues could also threaten the harmony in which Trinidad and Tobago's ethnically diverse population has lived throughout most of its history in marked contrast to many LDCs. Despite the increasingly blatant and crude attempts of political parties to appeal to ethnic constituencies, with the exception of relatively isolated occurrences, racial tensions have rarely been present in the recent history of the country. Indeed, modern Trinidadian culture is a remarkable fusion of the traditions of the peoples that make up its society. This harmonious integration could be endangered if some of the more urgent poverty-related problems are not addressed with some urgency, with a consequent increase in social instability.

45 This view was endorsed by both the American Chamber of Commerce and the Trinidad and Tobago's Manufacturer's Association who were interviewed during the field visit.
46 Trinidad and Tobago –Development Priorities for the next decade.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[47]					
		1	2	3	4	5	6
Political System	Rules					X	
	Structure				X		
	Management[48]			X			
	Combined Rating				**X**		
Legal Framework	Rules					X	
	Structure				X		
	Management			X			
	Combined Rating				**X**		
Financial System	Rules					X	
	Structure					X	
	Management					X	
	Combined Rating					**X**	
Corporate Governance	Rules				X		
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Trade & Competition	Rules					X	
	Structure					X	
	Management			X			
	Combined Rating				**X**		
Overall Rating					**X** **4.3**		

47 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good

48 Based on detailed management scorecard (see next page)

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability			X			
	Quality of Personnel				X		
	Effective Decision Making			X			
	Efficiency of Procedures			X			
	Costs / Waste			X			
	Corruption				X		
	Combined Score			**X**			
Legal Framework	Objective Setting & Accountability				X		
	Quality of Personnel				X		
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste			X			
	Corruption			X			
	Combined Score			**X**			
Financial System	Objective Setting & Accountability					X	
	Quality of Personnel					X	
	Effective Decision Making					X	
	Efficiency of Procedures				X		
	Costs / Waste					X	
	Corruption					X	
	Combined Score					**X**	
Corporate Governance	Objective Setting & Accountability					X	
	Quality of Personnel					X	
	Effective Decision Making			X			
	Efficiency of Procedures			X			
	Costs / Waste			X			
	Corruption			X			
	Combined Score			**X**			
Trade & Competition	Objective Setting & Accountability			X			
	Quality of Personnel				X		
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste				X		
	Corruption			X			
	Combined Score			**X**			

APPENDIX 1

MULTILATERAL DONOR DETAILS – NET ODA $M 1999								
	1971	**1975**	**1980**	**1985**	**1990**	**1995**	**1999**	**2000**
CarDB	-	-	-	-	0.35	-	0.22	-0.28
EC	0.11	-	1.00	8.30	9.93	20.98	25.67	-7.54
IDB Fund	11.39	3.02	0.18	-1.47	0.83	1.11	-0.73	0.03
UNDP	3.13	3.71	3.28	4.34	1.11	0.26	-0.02	0.10
All UN bodies	4.64	1.11	4.64	5.70	2.16	1.81	0.9	1.01
WB	-	-	-1.00	-	13.00	-	2	4

Source: OECD DAC online database

APPENDIX 2

MAIN AREAS OF ACTIVITY OF IFI'S

The main sectors of activity of core donors and multilateral lending agencies are summarised below:

INTERNATIONAL ORGANISATIONS: MAIN AREAS OF ACTIVITY	
Organisation	**Activities**
Inter-American Development Bank	Secondary Education Modernisation Health Sector Reform National highways, roads and bridges Agricultural sector reform Tourism development Community development fund Investment sector reform Credit union strengthening
World Bank Group	Financial sector supervision and regulation Basic education programme Environmental management reform Water sector loan Judicial reform
Caribbean Development Bank	Southern main highway Lines of credit
European Investment Bank	Micro, small and medium size enterprise development Road rehabilitation
European Commission	Small business support Caribbean export programme (regional) Agricultural credit Youth training Poverty alleviation Poverty reduction (UNDP,FAO)
UN Agencies	Institutional strengthening (UNDP) Land refor Environmental Protection (UNDP,FAO) Labour markets and training (ILO)
Japan EXIM	Up-grading of refinery

ADDITIONAL INFORMATION ON THE FINANCIAL SYSTEM

THE FOLLOWING EXHIBIT PROVIDES FURTHER INFORMATION ON THE FINANCIAL SYSTEM

1-Entry		Trinidad & Tobago
1.1 Licensing authority		The Central Bank of Trinidad and Tobago
1.2 Number of banks		6
1.3 Minimum capital entry requirement		TT$ 15
1.4 Is information on source of funds for capital required?		No
1.5 Are the sources of funds to be used as capital verified by authorities?		No
1.5.1 Are law enforcement authorities consulted?		No
1.6 Can assets other than cash/govt. securities be used to increase capital?		Yes
1.7 Can borrowed funds be used?		Yes
1.8 Legal submissions required for banking license:	1.8.1 Draft by-laws	Yes
	1.8.2 Intended organization chart	Yes
	1.8.3 First 3-year financial projections	Yes
	1.8.4 Financial information on shareholders	Yes
	1.8.5 Background/experience of future directors	Yes
	1.8.6 Background/experience of future managers	Yes
	1.8.7 Sources of funds in capitalization of new bank	No
	1.8.8 Intended market differentiation of new bank	No
1.9 Number of domestic applications for banking licenses		2
1.9.1 Number denied		1
1.10 Number of foreign applications for banking licenses		2
1.10.1 Number denied		0
1.11 Basis for denial of applications	1.11.1 Capital amount/quality	Yes
	1.11.2 Banking skills	Yes
	1.11.3 Reputation	No
	1.11.4 Incomplete application	No

2-Ownership		Trinidad & Tobago
2.1 Is there a maximum percentage of capital that can be owned by single owner?		No
2.1.1 If yes, what is it?		
2.2 Can related parties own capital in a bank?		Yes
2.2.1 If yes, what is the maximum percentage?		None
2.3 Regulatory restrictiveness of ownership by nonfinancial firms of banks		Unrestricted
2.4 Fraction of capital in 10 largest banks owned by conglomerates		not reported
2.5 Can non-bank financial firms own shares in banks?		Yes
2.5.1 What are the limits?		None
2.6 What is the 5-bank concentration ratio (%)?		75.3
3-Capital		**Trinidad & Tobago**
3.1 Minimum capital-asset ratio requirement (%)		8
3.1.1 Is it risk-weighted in line with Basle guidelines?		Yes
3.2 Does the ratio vary with a bank's credit risk?		No
3.3 Does the ratio vary with market risk?		No
3.4 Actual risk-adjusted capital ratio (%)		15.2
3.5 Is subordinated debt allowable (required) as part of capital?		Yes
3.6 What fraction of revaluation gains is allowed as part of capital?		Asset revaluation reserves should not exceed 20% of core capital
3.7 Percentage of banking system's assets in banks that are 50% or more government owned		15 as of Jun 99
3.8 Percentage of banking system's assets in banks that are 50% or more foreign owned		7.9 as of Jun 99
3.9 Before minimum capital adequacy is determined, which items are deducted from capital	3.9.1 Market value of loan losses	Yes
	3.9.2 Unrealised securities losses	No
	3.9.3 Unrealised foreign exchange losses	Yes
4-Capital		**Trinidad & Tobago**
4.1 Securities		Restricted
4.2 Insurance		Permitted
4.3 Real estate		Permitted
4.4 Regulatory restrictiveness of bank ownership of nonfinancial firms		Permitted
5 & 6 -Audit, management, org		**Trinidad & Tobago**
5.1 Is an external audit compulsory?		Yes
5.2 Are there specific requirements for the extent of audit ?		No
5.3 Are auditors licensed or certified?		Yes
5.4 Is auditor's report given to supervisory agency?		Yes
5.5 Can supervisors meet external auditors to discuss report without bank approval?		No
5.6 Are auditors legally required to report misconduct by managers/directors to supervisory agency?		No
5.7 Can legal action against external auditors be taken by supervisor for negligence?		No
5.8 Has legal action been taken against an auditor in last 5 years?		
6.1 Can supervisors force banks to change internal organizational structure?		No
6.2 Has this power been utilized in last 5 years?		
7-Liquidity		**Trinidad & Tobago**
7.1 Are there guidelines for asset diversification?		No
7.2 Are banks prohibited from making loans abroad?		No
7.3 Minimum liquidity requirement (%)		None but deposit liabilities are restricted to 20 times of a bank's paid up share capital and Statutory Reserve Fund.
7.4 What interest is paid on reserves?		

Minimum reserve requirement (%)	The Statutory Reserve Fund should not be less than the paid up capital, and in addition a cash reserve balance (the Reserve Account) bearing a ratio to the total prescribed liabilities of the institution is at 21%
How is reserve requirement remunerated	4% on balances held in the Reserve Account that are above the minimum
7.5 What assets satisfy liquidity or reserve requirements?	Cash; unpledged short term instruments; long term marketable instruments; short term loans maturing within the financial period; deposits held at the Central Bank
8-Depositor	**Trinidad & Tobago**
8.1 Is there an explicit deposit insurance scheme?	Yes
8.1.1 Is it funded by the government, banks or both?	Government
8.1.2 Ratio of accumulated funds to total bank assets	0.01153
8.1.3 Insurance limit per account	TT$ 50,000
8.1.4 Is there a limit per person?	Yes
8.1.4.1 Amount of limit	TT$ 50,000 for each individual plus an additional amount of TT$ 50,000 in case of an joint account with another individual
8.1.5 Does deposit insurance authority make the decision to intervene a bank?	No
8.1.6 If no, who does?	The Central Bank of Trinidad and Tobago
8.1.7 If yes, does the deposit insurance authority have the legal power to intervene/takeover a troubled (not insolvent) bank?	
8.2 As a share of total assets, value of denominated debt liabilities not covered by implicit/implicit savings protection scheme?	
8.3 Number of banks merged/closed (as part of failure resolution) in last 5 years	0
8.4 Were depositors wholly compensated the last time a bank failed?	Yes
8.4.1 Average time to pay depositors in full	1 year
8.4.2 Longest that depositors waited in last 5 years	3 months from submission of claims
8.5 Were any deposits that were not covered at the time of failure compensated when bank failed?	No
8.6 Can deposit insurance agency take legal action against bank directors/officials?	Yes
8.7 Has the deposit insurance agency ever taken any legal action against bank directors/officials?	No
9-Provisioning	**Trinidad & Tobago**
9.1 Is there a formal definition of "non-performing loan"?	Yes
9.1.1 If yes, what is it?	Where payment of principal or interest which is due and payables on any credit facility made or advanced by a license has not been made or effected for a period of 90 days, such credit facility is considered non-performing unless it is fully secured and is in the process of collection

9.2 Classification of loans in arrears:	9.2.1 Substandard	90 to 179
	9.2.2 Doubtful	180 to 365
	9.2.3 Loss	365+
9.3 Minimum required provisioning of loans as they become:	9.3.1 substandard	20
	9.3.2 doubtful	50
	9.3.3 loss	100
9.4 Other classification systems		"Default of debtor" depends on various criteria; one of which is loan being past due by more than 30 days. The quality of collateral is taken into account to determine provisioning requirements.
9.5 Ratio of non-performing loans to total assets (%)		0.021
9.6 If one loan is non-performing, are other loans of a multiple-loan customer classified as non-performing?		No
10-Disclosure		**Trinidad & Tobago**
10.1 Does income statement contain accrued but unpaid interest/principal while loan is performing?		Yes
10.1.1 Does income statement contain accrued but unpaid interest/principal while loan is non-performing?		No
10.2 Number of days in arrears after which interest income cease to accrue		90
10.3 Are consolidated accounts covering bank and any non-bank financial subsidiaries required?		Yes
10.4 Are off-balance sheet items disclosed to supervisors?		Yes
10.4.1 Are off-balance sheet items disclosed to public?		No
10.5 Must banks disclose risk management procedures to public?		No
10.6 Are directors legally liable for erroneous/misleading information?		Yes
10.6.1 Have penalties been enforced?		No
10.7 Do regulations require credit ratings for commercial banks?		No
10.7.1 What percentage of top ten banks is rated by international credit rating agencies?		not applicable
10.7.2 What percentage of the top ten banks are rated by domestic credit rating agencies?		
10.7.3 Which bank activities are rated?	10.7.3.1 bonds	
	10.7.3.2 commercial paper	
	10.7.3.3 other	
11-Discipline		**Trinidad & Tobago**
11.1 Are there any mechanisms of cease-desist type orders whose infraction leads to automatic imposition of civil & penal sanctions on banks directors & managers?		Yes
11.2 Can the supervisory agency order directors/management to constitute provisions to cover actual/potential losses?		Yes
11.3 Can the supervisory agency suspend director's decision to distribute:	11.3.1 dividends	Yes
	11.3.2 bonuses	No
	11.3.3 management fees	No
11.4 Any such actions taken in last 5 years?		No
11.5 Which laws address bank insolvency?		Section 32 of the FIA 1993
11.6 Can the supervisory agency supersede bank shareholder rights and declare bank insolvent?		No

11.7 Does banking law allow supervisory agency to suspend some or all ownership rights of a problem bank?		No
11.8 Does the law establish pre-determined levels of solvency deterioration which forces automatic actions such as intervention?		No
11.9 Regarding bank restructuring & reorganization, can supervisory agency or any other govt. agency do the following:	11.9.1 supersede shareholder rights	No
	11.9.2 remove and replace management	Yes
	11.9.3 remove and replace directors	Yes
	11.9.4 forbear certain prudential regulations	Yes
	11.9.5 insure liabilities beyond any explicit deposit insurance scheme	No
11.10 Number of banks closed in last 5 years		0
11.10.1 Percentage of total bank assets accounted for by these banks		
12-Supervision		**Trinidad & Tobago**
12.1 Bank Supervision Authority		The Central Bank
12.1.1 Is there more than one supervisory body?		No
12.2 To whom are supervisors accountable?		The Minister of Finance
12.2.1 How is head of supervisory agency/other directors appointed?		By the President upon recommendation from the Minister of Finance
12.2.2 How is head of supervisory agency/other directors removed?		By the President upon recommendation from the Minister of Finance
12.3 Any important differences between expectations from supervisory agency and what is mandated by law?		None
12.4 Total number of professional bank supervisors		36
12.4.1 Number of professional bank supervisors per institution		6
12.5 Number of onsite examinations per bank in last 5 years		12
12.6 Total budget for supervision		TT$ 5.6 (1998)
12.7 Frequency of onsite inspections conducted in large & medium size banks (annually=1; every two years =2)		2
12.8 Average tenure of a supervisor (years)		10
12.9 frequency of supervisors employed by banking industry subsequent to retirement (never=0, rarely=1, occasionally=2; frequently=3)		2
12.10 Must infraction of any prudential regulation found by a supervisor be reported?		Yes
12.11 Any mandatory actions in these cases?		Yes
12.12 Who authorizes exceptions to such actions?		The Inspector of Banks
12.13 Number of exceptions granted last year		0
12.14 Are supervisors legally liable for their actions?		Yes

COUNTRY REPORT - UGANDA

MANAGING A POST-CONFLICT ECONOMY

1. DEVELOPMENT PERFORMANCE

1.1 Economic Performance

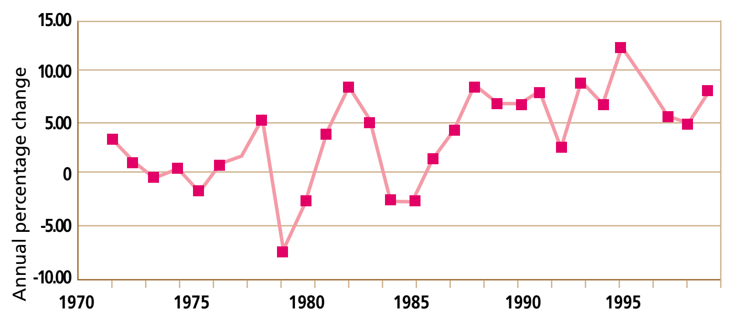
Post-independence decline. In the years after independence from Britain in 1962, Uganda was one of the success stories of independent Sub-Saharan Africa (SSA). Between 1963 and 1973, the country recorded an annual average GDP growth rate of about 6%, largely driven by its successful agricultural sector and good rainfalls, as well as the mining of some mineral deposits. However, by the late 60s, there was political instability, followed by the first of many coups in 1971, leading Uganda to spiral into economic turmoil and insecurity. By 1979, the GDP growth rate had plunged to –11%, inflation was well over 200% and money supply growth had risen to 52%.

The first economic reforms in Uganda, with the support of the Bretton Woods institutions were introduced in 1980. The IMF provided a series of three stand-by arrangements, which were followed by loan facilities from the World Bank and debt rescheduling for the Paris Club. The resultant recovery – GDP growth rate of an average 6% (1981-83), inflation declined to 24% as did money supply growth – did not last because of the worsening political instability and the start of a civil war. The government failed to meet the IMF conditions and in 1985 inflation rose to 158% and money supply to 125%, with exports falling and the economic growth declining by 10% to –3% (see exhibit 1). The IMF withdrew its programme. In 1986 the government fell, and the National Resistance Movement led by Yoweri Museveni assumed power.

Turning point: 1986 was a difficult year – inflation was still in triple digits at a time of huge financial requirements to rehabilitate the economy. The civil war had left its mark on the transport network, power and water facilities, a fixed exchange rate had eroded the country's competitiveness, and negative net exports lead to annual declines in terms of trade. Furthermore, the economy was awash with money (liquidity overhang) feeding directly through accelerating inflation. The banking system was insolvent and foreign exchange reserves provided less that two weeks import cover, exacerbating viability of the already weak firms still operating within the dying private sector.

REAL GDP GROWTH IN UGANDA

Exhibit: 1



Source: Compiled from the World Economic Outlook database, IMF

MACRO ECONOMIC INDICATORS

Exhibit: 2

	1970	1975	1980	1983	1987	1989	1990	1995	1998	2000
Govt deficit (-) / surplus (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-6.5	-6.4	-11.5
Inflation (%)	74.9	74.9	99.2	150	215.4	130.8	45.4	6.1	5.8	6.3

Source: Compiled from International Financial Statistics: IMF, various

The then pro-socialist President was at a loss as to how to stem the decline, so on the advice of a team of international economists and some influential local academics and entrepreneurs the government opted for a controlled model. This was a serious mistake, which fuelled macroeconomic instability, and led to a significant change in the president's perceptions of economic development.

Economic recovery. Faced with uncontrolled inflation, exchange rate deprecation, and deepening poverty, in 1987 the government embarked on an Economic Recovery Programme (ERP) with the support of the IMF and the World Bank. The first two years of the Museveni government were difficult, characterised by tightened foreign exchange constraints, volatile budgetary discipline and the collapse of institutional structures. Inflation continued to rise, reaching more than 200% in 1987. However, by the early 90s, Uganda was on the road to economic recovery (see exhibit 2).

The key to the ERP was national currency reform, aimed at stabilising prices. An initial devaluation was followed at the end of 1989 by a radical liberalisation of the foreign exchange system (legalising the parallel market). The government made this key reform without any conditionality pressure from the IMF or World Bank. The country recovered spectacularly, with inflation falling to 28% and money supply to 52% by 1991. GDP grew at an average of 7% p.a. between 1988-1991. There was some recovery in the export sector (with coffee benefiting from the lower exchange rate), and the industry and service sectors recorded impressive performance.

The road to sustained growth: In 1991 and 1992 the government introduced wide-ranging policies intended to promote economic stabilisation. The main objective of these corrective macroeconomic measures was to ensure tight fiscal and monetary policies. In 1994, a three-year programme that put emphasis on structural and institutional reforms was agreed with the IMF, followed by a World Bank structural adjustment credit in the same year. A new ESAF in 1997 focused on macroeconomic stability, private sector promotion, export-oriented growth, and structural and institutional reforms to further encourage growth and job creation. In the same year Uganda signed Article VIII of the IMF, removing current account restrictions, and later in the same year became one of the very few African countries to accept full capital account convertibility. The World Bank approved a third structural adjustment

SELECTED ECONOMIC INDICATORS (1998-2000)

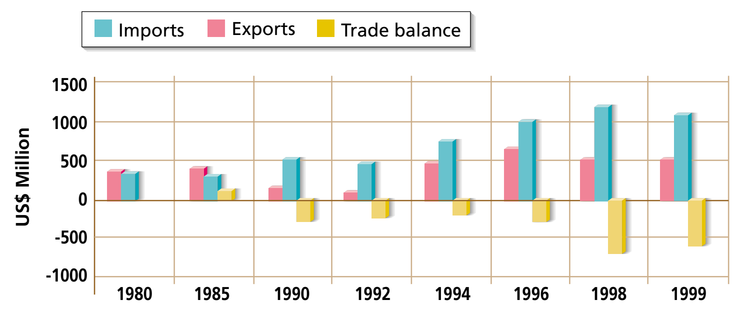
Exhibit: 3

Indicator	1998	1999	2000
GDP growth (%)	7.7	4.7	5
Money supply growth (%)	9.1	8.8	12.3
Current Account (US$ million)	-475.72	-525.29	-444.67
Exports (US$ million)	549.14	438.91	407.48
Imports (US$ million)	-1391.5	-1513.35	-1503.1

Source: Uganda MoF, Background to Budget 2001-2002

TRADE IN UGANDA

Exhibit: 4



Source: IMF Statistics

KEY EXPORTS AND IMPORTS IN UGANDA (AS A % OF TOTAL)

Exhibit: 5

	1994	1996	1998	2000
Exports				
Coffee	76%	63%	56%	32%
Cotton	1%	1%	1%	5%
Tea	2%	2%	5%	7%
Tobacco	2%	1%	4%	7%
Fish& Fish Products	3%	7%	8%	6%
Gold	n.a.	6%	4%	8%
Imports				
Petroleum	5%	13%	10%	8%
Machinery, Vehicle & Accessories	30%	30%	24%	28%
Vegetable Products	11%	11%	13%	10%
Mineral Products	5%	4%	4%	4%
Chemicals & related products	9%	11%	14%	13%
Textiles	9%	3%	3%	4%

Source: Bank of Uganda, World Bank and UNCTAD

credit in 1997, aimed at stabilisation and acceleration of economic growth through long-term fiscal sustainability, involving a more efficient tax system as well as better management of public expenditures.

The economy's major variables all responded well to the measures. There was a slight dip in 1996/97 because of the effects of the El Niño causing drought, which affected all of Southern Africa. That notwithstanding, the following was achieved in the period 1992-1998:

- Private sector investment increased from 9% of GDP in 1991 to 13% in 1998.
- GDP growth rate averaged 7.6% p.a. in that period.
- Inflation declined to an average 8% p.a., down from 190% in the period 1987-91.
- The current account deficit to GDP ratio narrowed from 6% in 1992 to 4% in 1996.
- Monetary deepening (M2/GDP) occurred, with the ratio increasing to 11.7% in 1996 from 8.2% in 1992.
- Gross domestic savings rose from 2% in 1987 to 8% in 1997
- Foreign exchange cover (measured in terms of import cover) increased from two to about five months.

From 1999 through to 2000, Uganda, like many Sub-Saharan African countries, was been adversely affected by the deterioration in terms of trade due to increasing international oil prices. The decline in world coffee prices, prolonged drought in some parts of the country, and the ban imposed on fish exports by the EU has also hindered growth. Consequently, private incomes (mainly from farming) have declined, affecting consumption and private investment, as capital flowed towards social development, not the productive sector. However, despite these exogenous shocks, Uganda still achieved reasonable growth rates of 4.7% and 5% in 1999 and 2000 respectively (see exhibit 3).

Once Uganda adopted liberal and prudent macroeconomic policies, economic growth was driven by agricultural production. The sector, accounting for over 20% of GDP, grew by an average of 3.3% over the 1990-99 period. Manufacturing, contributing less than 10% (its share has been declining) grew at an average of 13% p.a. between 1995–99 showing the potential of this sector. Initial efforts were to increase utilisation of existing factory capacity and improve agricultural production efficiency. The central goal of the reform programmes was to improve overall production from its low base of the early 80s, and shift production from the public to the private sector. By the end of the 90s, the government and its donor partners had gone a long way towards reaching these objectives. The share of private capital formation as a percentage of GDP increased to 13% in 1998/98 from 7% in 1989/90. In the same period, public capital formation declined from 7% of GDP to 5%.

1.2 Trade

Since independence in 1962, the composition of Uganda's exports has remained largely the same, with agriculture products comprising 60% of total exports. These are characterised by high volatility in international markets (see exhibit 4) and the vagaries of natural disasters like droughts and diseases. Export diversification is therefore essential.

As shown in exhibit 5, traditional exports include coffee, cotton, tea, and tobacco. Although declining, the share of coffee export earnings is predominant, recording 32% in 2000. Tea exports have grown substantially, comprising 7% in 2000. Gold exports are also becoming an important source of revenue (8% of total exports in 2000). The non-traditional export sector has over the last decade experienced substantial growth, albeit from a very low base. Rose flowers and plant cuttings increased from US$3.6 million in 1995 to US$14.6 million in 2000. Exports of fresh produce (including French beans, fruits, and other vegetables) increased to US$3.6 million in 2000 from US$0.63 million in 1994. Uganda's primary imports are machinery, vehicles and accessories, petroleum, chemicals and related products and vegetable products.

The largest share of exports is destined to the European Union, representing 40.8% in 1999, (see exhibit 6). Within the EU, the United Kingdom is at the top with 8% of total exports, followed by the Netherlands (6%) and Belgium (5%). COMESA countries have increasingly become an important market, receiving 30.2% of the exports in 1999, with Kenya consistently the largest trading partner in this group because of its proximity (it accounted for 6% of total exports in 1999). An opportunity to increase exports to the USA exists under the African Growth and Opportunity Act (AGOA), which Uganda has yet to fully take advantage of.

The largest origin of imports was Asia (28.7%) in 1999, followed by the EU (22.2%) and COMESA (21.3%). Intra-regional import plays an important role in Uganda, but Kenya's (20%) role is somewhat overstated because many goods to landlocked Uganda pass through Kenya's seaports first. The United Kingdom (8%), Japan (6%), India (5%), and USA (4%) are key trading partners.

TRADE DESTINATION /ORIGIN (1999)

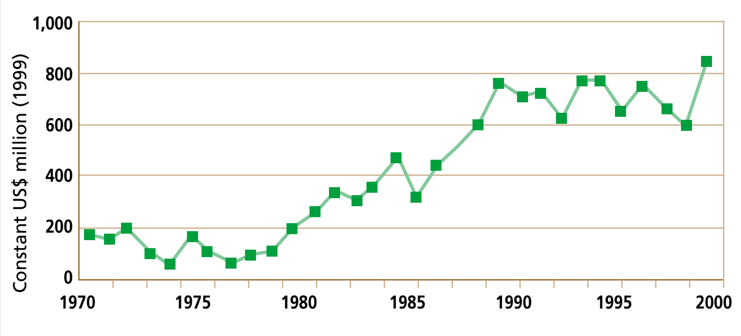
Exhibit: 6

	Exports (% of total)	Imports (% of total)
EU	40.8	22.0
Rest of Europe	4.3	2.5
The Americas	1.0	7.4
Middle East	1.4	8.6
Asia	6.0	28.7
Comesa	30.2	21.3
Rest of Africa	11.0	7.5
Unclassified	5.2	1.8

Source: Bank of Uganda

NET PUBLIC FLOWS EVOLUTION (ODF) IN UGANDA

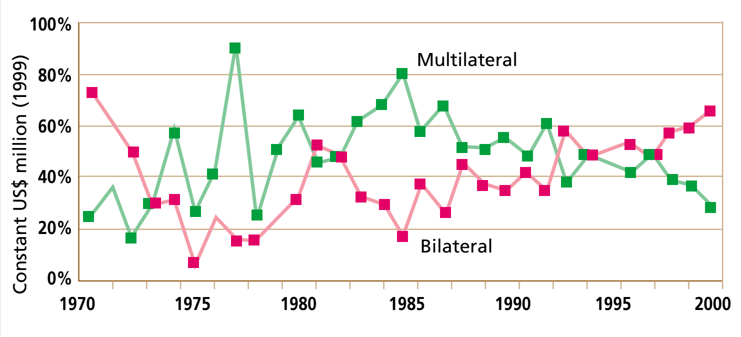
Exhibit: 7



Source: OECD Online database

SHARE OF MULTILATERAL AND BILATERAL AID IN TOTAL ODF

Exhibit: 8



Source: OECD Online database

1.3 Development aid

Official aid flows

The overall trend of aid flows to Uganda reflects the country's economic history. The poor economic policies, deep-rooted economic mismanagement and civil war led to catastrophic declines in the Ugandan economy in the period between independence and the mid-80s. The tentative plans at economic reform in 1981-83 saw the first IMF and World Bank standby and reconstruction credits, and the country's first Consultative Group Meeting was convened in 1982. Until the present government came to power in 1986, ODA was relatively small, below US$200 million (representing 2% of total GDP of Sub-Saharan Africa), as shown in exhibit 7.

By 1986 total net ODA was double its value in 1980, and by 1990 Uganda was receiving an equivalent of 4% of total ODA destined for Sub-Saharan Africa. This share reached 6% by 2000. Some 21 countries have been active donors since 1987, but in the immediate recovery period substantially more aid came from the multilateral institutions.

The government's ERP was strongly supported by the IMF and the World Bank. The World Bank provided about 25 policy-based credits under that programme, amounting to more than US$1 billion in between 1987-92. The IMF's credit to Uganda rose from under US$100 million in 1980 to over US$300 million in 1983, and then remained relatively stable, at an average US$300 million until the end of the 90s. The drop in 1986 reflects the suspension of the standby agreement after the government failed to meet the IMF conditionalities (refer to appendix 2). However, the country still benefited from non-financial assistance in that period. The period of remarkable growth in the Ugandan economy coincides with increased ODA receipts, as both multilateral institutions and bilateral donors supported the government's reforms. Since its policy turnaround in 1986/87, the government has (and still) viewed conditionality as a positive tool for generating, implementing, and cementing reforms (Tumusiime-Mutebile, 1995). In fact some in government argue that conditionality was never imposed, it was an economic necessity, which the authorities factored into their reform policies and programmes. Therefore, unlike some of its African peers, Uganda has enjoyed a close relationship with the donors.

Multilateral aid flows dominated total net ODA flows to Uganda until the mid-90s in line with the numerous financial packages from the IMF and World Bank. Bilateral aid for instance rapidly declined between 1981 and 1985, falling from almost 60% of total aid to 25% as OECD donors withdrew support from the

SHARE OF ODA BY DONOR (US$ MILLION 1999)

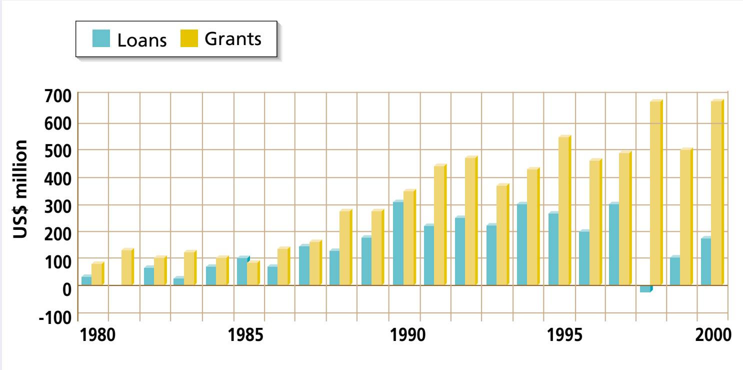
Exhibit: 9

	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1999
EU members*	21.17	11.37	44.81	82.65	156.77	196.06
Japan	4.65	1.72	5.48	4.97	24.80	28.55
UK	29.07	4.08	19.62	35.69	55.50	87.77
US	10.26	0.00	9.88	11.36	38.20	42.33
Other	4.03	1.41	9.84	9.60	13.84	6.15
Total	69.18	18.58	89.64	144.27	289.11	360.87
*** w/out UK**	69.18	18.58	89.64	144.27	289.11	360.87

Source: OECD DAC online database

LOANS AND GRANTS TRENDS 1980-2000

Exhibit: 10



Source: MoF, Aid Unit Aid Liaison Department, March 2001

DISBURSEMENT BY TYPE OF ASSISTANCE (US$ MILLION)

Exhibit: 11

	1993	1994	1995	1996	1997	1998	1999	2000
Debt Relief	24.8	19.1	59.5	40.1	53.0	36.2	0.0	0.6
Import Support	170.7	204.9	73.7	82.0	123.2	62.7	159.8	61.8
Other Balance of Payments Support	6.2	54.7	113.6	67.2	98.7	76.5	47.6	3.7
Emergency Relief	0.4	1.6	0.2	0.8	2.4	2.6	1.9	0.0
Food Aid	2.2	3.4	17.1	16.5	23.6	23.3	33.3	8.4
Free Standing Technical Assistance	47.4	57.5	47.4	55.4	69.5	80.3	84.4	98.9
Investment Project	221.6	275.9	251.7	295.3	321.6	360.2	316.3	186.4
Investment Related Technical Assistance	80.6	78.2	75.6	76.4	82.5	85.8	95.4	50.7
Other Project Assistance	1.9	0.7	2.3	5.4	14.2	27.5	14.4	10.8

Source: MoF, Aid Liaison Department, March 2001

repressive regimes. After 1995 bilateral donors also increased level of funding, which accounted for more than 70% of total ODA to Uganda in 2000 (see exhibit 8). This increase in bilateral flows is notable because it happened at a time when there was a global decline. The change in the composition was a reflection of a combination of the favour in which the Museveni government was perceived by donors and the government's concern relating to a ballooning debt profile.

The European Union member countries as a group represent the largest donor to Uganda, accounting for over 50% of total net ODA in 1995 to 1999. The UK is the single largest donor, providing about one-quarter of the net ODA, with net flows increasing in real terms from US$29 million on average in 1970-74 to US$88 million on average in the period 1995-99. The US represents the second largest donor, disbursing US$42 million on average in the 1995-99 period.

There has been a strong, steady build-up in grant disbursements to Uganda, which became more pronounced as of 1988. Starting below US$100 million in 1980, aid grants more than quadrupled by the early 90s to reach over US$400 million, reaching almost US$700 million in 1998 and 2000 (see exhibit 10). In terms of total share over the period 1980-2000, loans represented an average 32% p.a. of total aid to Uganda against 68% for grants. As mentioned above, this reflects the government's prudent debt management strategy after the implementation of both the original HIPC Initiative[49] (1997) and the Enhanced HIPC Initiative (2000), which saw reduction in the debt stock by US$1 billion in net present value terms. In addition to HIPC, Uganda benefited from at least six debt reschedulings from the Paris Club since 1981 (before the HIPC Initiative was introduced a portion of the multilateral debt was serviced by a number of bilateral donors). A commercial debt buy-back scheme with IDA support was successful in 1993 (US$153 million of commercial debt was bought at 12 cents per dollar).

Allocation of Aid

The last decade witnessed a re-structuring of aid by use, thanks to an efficient public expenditure management. The Ministry of Finance was lately advocating (and to date, the donors have supported the change) that donor funds be utilised as part of the national budget to enable effective and efficient support for sector-wide strategies. Historically, bilateral donors tended to finance specific projects, leading to duplication of effort, wastage, stretching scarce management resources and complicated and sometimes unsatisfactory monitoring and supervision. Since the early 90s, aid has ranged between 33% and 66% of total public expenditure; it comprised 52% of the annual budget in 2000. The government therefore argues that because they have opened up the budgeting and monitoring process. Several of the large donors (World Bank and the EC) confirmed their confidence in the government's level of accountability and transparent use of funds. A few donors (e.g. USAID, Japan) will continue to provide tied project funding as budget support is not easily allowed under their constitutions. However, even this ring-fenced funding will be in line with the sector-wide strategies set out by the government.

As shown in exhibit 11, the bulk of aid disbursements to Uganda are channelled to supporting imports or for investment purposes, with the latter using up almost half of all aid disbursements. The share of investment project has remained constant over the period 1993-2000, at around 40% of total aid disbursed, whereas aid for import support (which represented on average 18% of the resources) fell from over 30% in 1993 to below 10% in 1998. Aid for debt relief represents a small proportion of around 6% on average of total aid

49 HIPC is the ground breaking comprehensive debt relief programme supported by the World Bank and IMF, as well as major bilateral and regional lenders. Uganda was the first country to receive relief under HIPC.

disbursements. (Of note is the fact that debt relief aid was almost non-existent in Uganda in the 1999-2000 period.) Investment-related technical assistance takes up approximately 10-11% of all disbursed aid and free-standing technical assistance a little bit above that amount.

In terms of sectoral assistance, the multi-sector programme receives a considerable share of the resources at 33.9%. This is followed by the health sector with 10.9% and multi-sector project aid at around 7%.

Private flows

Net private capital flows increased dramatically during the 90s (as shown in exhibit 12). Averaging US$97 million in real terms (constant US$ 1999) during the 90s compared with an annual average of US$35 million during the 80s and US$46 million over the 70s, net private capital flows reached a high of US$220.6 million in 1999. Net flows of foreign direct investment were the main driver behind net private capital flows in the 90s. Increasing from US$18 million (in real US$ 1999 terms) in 1970 to US$230 million in 1999, foreign direct investment grew from 40% of net private capital flows in 1970 to 104% in 1999.

Role of aid and its effectiveness

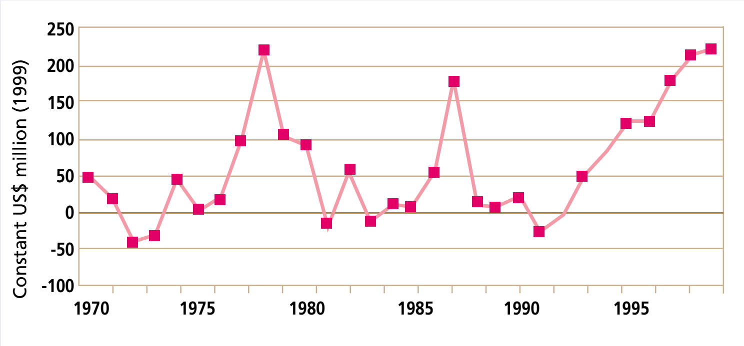
Post-conflict Uganda has benefited from generous foreign aid, and the country made exceptionally good use of the support, including learning from the experiences of other African reformers such as Ghana (Reinikka and Collier, 2001). However, in many respects Uganda has been at the forefront of the changing face of aid utilisation and effectiveness. On the basis of its strong adjustment record, Uganda became the first country to become eligible for debt relief under the Highly Indebted Poor Countries (HIPC) Initiative in April 1997. Prior to the IMF and World Bank formalisation of pro-poor economic policies as the basis for credit availability[50], Uganda had already designed (in 1996/97) and was implementing its home-grown PEAP. The PEAP was founded on four pillars under which strategies and priorities that are key for poverty reductions are identified and to the extent possible, targets are set. The pillars are

- Economic growth and structural transformation for poverty reduction
- Good governance and security
- Increasing the ability of the poor to raise their incomes
- Improving the quality of life of the poor

The PEAP was the basis for Uganda's PRSP, a pre-requisite for further debt relief under the Enhanced HIPC.

NET PRIVATE FLOWS EVOLUTION IN UGANDA

Exhibit: 12



Source: OECD-DAC Online database

There is evidence of a notable positive impact of development aid to Uganda on economic growth and poverty reduction. (For poverty see the next section.) In a research study to quantify the effects of aid, Collier and Dollar (1999) analysed data from more than 100 countries to test the hypothesis that the better the policy environment, the more effective aid is in raising growth and that aid is subject to diminishing marginal returns. They conclude that the hypothesis appears to be true. Reinikka and Collier (2001) applied the analysis on Uganda, where they calculated that in the absence of aid, the growth rate per capita would have been much lower that recorded over the last 15 years. According to this study, the contribution of aid was at least 31% of the actual growth rate registered[51]. The authors even argue that this is on the conservative side, citing other research, which has demonstrated that in Uganda aid has had a positive effect on policy formulation, so that the overall growth effect of aid is likely to be somewhat greater than their calculation estimated.

Aid and non-governmental organisations (NGOs) in Uganda

Nowadays Uganda accounts for more than 3,000 NGOs, which play an important role in the in the provision of advocacy, in monitoring (economic policy, community development and political reconciliation) and in service delivery within the participatory approach set by the government. The increase in bilateral donor interest in Uganda since the early 90s has been matched by a proliferation of NGOs, from about 1,000 in the mid-90s to more than 3,000 in 2000, making co-ordination of their activities very difficult. The two main functions of NGOs and civil society organisations (CSOs) are service delivery and advocacy (including community development and political reconciliation). NGOs' advocacy activities are independent from those instituted by the government, and are supported by the donors (financially and in terms of technical assistance). In service delivery, NGOs provide input to several sectors, including education, health, water supply and agricultural information. The donors have agreed to the government's request that donor funding for these activities be integrated within the sectoral framework.

Other than the major international NGOs (e.g. Oxfam, Action Aid, World Vision) there has been a positive emergence of well-managed local organisations acting as effective lobbyists. The most influential of these is the Uganda Debt Network (UDN), which has participated in debt policy issues with the government. UDN was also active in the international campaign that led to the Heavily Indebted Poor Country Initiative in 1997 (Uganda became the first country to benefit from debt relief under the scheme). The umbrella group of NGOs – the Uganda National NGO Forum – is another leading organisation, involved in monitoring the Poverty Action Fund. The Forum has been participating in the Consultative Group Meetings of multilateral and bilateral donors and lenders since 1998.

As part of its policy to streamline public expenditure, the government is instituting the use of budget support and sector-wide financing. The donors have broadly embraced the need for co-ordination; as a general rule aid will in the future be given as budget support and in exceptional cases, channelled in line with the government's sector-wide programmes. Whilst CSOs support this shift in approach, some of the smaller local organisations are concerned at the changing relationship between them and the government and donors will push CSOs into the role of sub-contractor. Others have raised concerns about their independence being diminished as direct funding for service delivery might decline.

50 The IMF introduced the PRGF to replace the ESAF, and the World Bank requires countries to prepare and present a PRSP prior to accessing HIPC.
51 Ritva Reinikka and Paul Collier, 2001, Uganda's Recovery: The Role of Farms, Firms and Government, page 43.

While the government is concerned that the large numbers of NGOs and CSOs makes it difficult to coordinate initiatives and plan for the equitable allocation of resources, the organisations complain that the government tends to merely use their participation for information dissemination purposes rather than real consultation. This is not entirely accurate, as the role of the UDN in debt policy and that of the NGO Forum in the PAF monitoring shows. Nevertheless, NGOs want their relationship with the government formally institutionalised. The argument is that they would then be more effective and increase transparency and accountability in the implementation of policies.

Donors (who generally finance these organisations), the government and other commentators acknowledge their positive contribution to date; in particular they have excelled in the provision of advocacy and monitoring (economic policy and community development and political reconciliation) and service delivery (particularly in the key sectors of education, health, water supply and agricultural information). However, there are some problems, which constrain their effectiveness. With the exception of the international NGOs and the large well-established local ones, most of the civil society organisations are characterised by weak management and professional capacity seen elsewhere in the Ugandan economy and society, inhibiting the quality of their contribution to policy. Therefore there is concern that some organisations have been too dependent on short-term external experts thus failing to respond to locally driven agendas and failed to promote sustainable local capacities.

However, generally, in Uganda civil society participation has been premised on the belief that active involvement leads to accelerated social progress because of increased ownership of public policies, programmes and plans. It also leads to increased transparency and accountability of government and plurality of voices, which in turn fosters good governance and security. On many levels, this approach has delivered well as NGOs and CSOs influence policies aimed at poverty reduction.

1.4 Poverty reduction

The government of Uganda's primary objective is to achieve strong sustained economic growth, allowing it to significantly reduce the level of poverty among its people. Therefore a strong partnership between government, donors, and civil society has been deliberately forged and cultivated, with the sole purpose of designing, implementing and managing pro-poor economic and social reforms. The major pillars of the government's strategy are continued structural reforms under its umbrella Poverty Eradication Action Plan (PEAP), launched in 1997, supported by financial resources from its donor partners, and overt political commitment from President Museveni.

During the 80s there was no direct policy intervention aimed at reducing poverty. When it was realised that some vulnerable groups were being adversely affected by the ERP, a special Programme to Alleviate Poverty and the Social Costs of Adjustment were designed and funded by the World Bank. These were intended to mitigate the social costs that arose from the demand management measures (particularly fiscal tightening) associated with structural adjustment programmes. Only after Museveni was elected to the presidency in 1996, and some economic stability had been restored to the ravaged economy, was there a concerted effort to re-direct economic policy towards specifically targeting poverty in Uganda by introducing direct intervention.

To operationalise the strategies, the government has over the years established more narrowly targeted and measurable policies including the medium-term expenditure frameworks (MTEF) and the Plan for Modernisation of Agriculture (PMA). Within these strategies key programmes were drawn up for improving the road network, the provision of clean water and sanitation, universal primary education, primary health care and governance, and for the promotion and development of the private sector.

It is important to note at this stage that to date, the focus of policy reform and aid has been social development, specifically education and health, with the productive sector lagging well behind as can be evidenced by the weak structures in the private sector (see sections under Institutional Infrastructure). The distribution of financial resources (both national Budgets and development aid) has been deliberately skewed towards the sectors with immediate and direct impact on poverty alleviation. This is further boosted by the Poverty Action Fund, into which the government directs all savings from the debt relief initiatives (it also receives direct bilateral donor funds)[52].

For the purpose of this section, focus will be on the impact of economic growth and aid flows on alleviating poverty in Uganda by assessing developments in the social sectors. Several research studies, the government, multilateral institutions and NGOs used macroeconomic data and results of the annual household surveys to assess the trends in poverty in Uganda. While it is widely acknowledged that Uganda is a successful reformer, controversy exists regarding the level of poverty alleviation, primarily because of the gaps in official data[53]. In particular, the UNDP and some NGOs have questioned how truly the official data (especially household surveys) capture rising living standards among the poor.

However, these dissenting voices notwithstanding, Uganda is one of the few Sub-Saharan countries that have convincingly addressed poverty as measured by private consumption. This can be assessed by the large-scale household survey programme, initiated in 1992 and since then augmented into an annual integrated household survey[54] (IHS) designed to monitor living standards. In the period 1992-97, the growth in mean consumption per capita estimated in the household surveys matched that reported in the national accounts. Households were better off in 1997 than in 1992, implying that poverty was reduced in this period and, more importantly, the data shows a reduction in inequality since at the lower points of the income distribution living standards rose above the mean. The headcount index of poverty fell from 56% in 1992 to 44% in 1998, and this decline was almost entirely attributable to economic growth in that period. According to Reinikka and Collier (2001) 29% of the decline in poverty was due to aid[55].

As shown in exhibit 13, the reduction in poverty is variable across regions, with the largest falls recorded in the central region and the least in the Eastern region (note that the IHS excludes the Northern districts still under armed civil strife). Furthermore, poverty among subsistence food crop

52 The PAF provides a mechanism for ensuring the re-allocation of the incremental expenditures directly prescribed priority areas such as the ones listed under the PEAP, plus agricultural extension, law and order, and equalisation grants whose purpose is to make the quality of service delivery more even across districts, the judiciary system, control of HIV/AIDS, adult literacy, protection of wetlands and commercial justice reform..

53 In 1997 the UNDP in its annual Human Development Report voiced this specific concern: "The perennial concern is that the benefits of strong [economic] growth have yet to translate into measurable improvements in the standard of living for the majority of people". Many NGOs quote a Government report published in 1999 – the Uganda Participatory Poverty Assessment Project (UPPAP) – which consulted the electorate on poverty issues. The report concluded that most Ugandans felt poverty had worsened in their communities with more people moving into rather than out of poverty. The problem appears to have been twofold. National accounts tell little about the distribution of incomes because they leave out informal sector economic activities, and the UPPAP used a wider concept of poverty. Its definition of poverty went beyond the private consumption measured in the household surveys and includes insecurity and poor provision of government services

54 The annual surveys have large samples, typically 5,000 households in about 500 different communities.

55 The simplest way to estimate the impact of aid on poverty is to use the ratio of the growth rate attributable to aid and the actual growth rate multiplied by the decline in the headcount index that was attributable to growth.

producers, representing 44% of the total population declined only marginally, from 64% in 1992 to 62% in 1997. Yet, coffee producers, on the other hand, benefited from the liberalisation of the industry and boom in international prices during that period. Generally, incidence of poverty among cash crop producers declined from 60% to 44% in the period 1992-97.

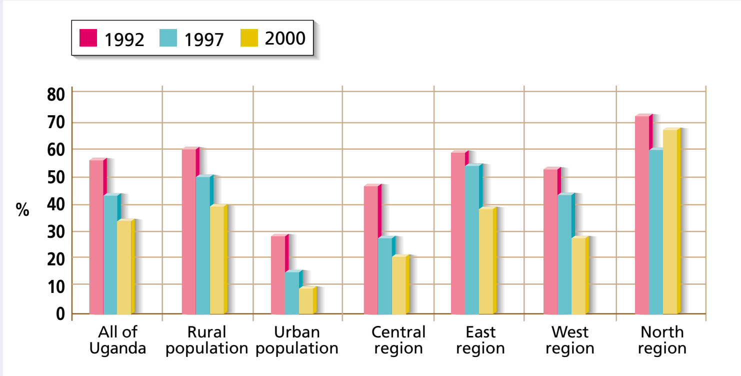
An analysis of the provision of public services shows a focus on universal primary education and health (see exhibit 14). In 1997 the government adopted universal primary education as a national goal. The government's schools surveys of 1996 and 2000 show an improvement in the number of children attending school, but the rapid extension of education services has been at some cost to quality. Whilst serious concern remains about the spread of AIDS, there is evidence that child mortality has been falling (Demographic and Health Surveys of 1988 and 1995) while still worse than that for the HIPCs and Sub-Sahara countries.

Uganda relative performance compared with similar LDCs

The key economic and social indicators shown in exhibit 15 reflect that Uganda is below average in most of the development challenges. The country's GNI per capita is 60% that of Sub-Saharan countries and 30% lower than that of LDC countries. Social indicators are worse in Uganda than in other similar countries and only the primary gross enrolment seems to be slightly better than other indicators. Uganda's efforts on economic reforms and poverty alleviation are still not being reflected and more needs to be done.

INCIDENCE OF CONSUMPTION POVERTY

Exhibit: 13



Source: Uganda Poverty Status Report, 2001

SOCIAL INDICATORS (1975, 1985, 1995, 1999)

Exhibit: 14

	1975	1985	1995	1999
Infant mortality rate (per 1,000)	111	116	98	88
Life expectancy at birth (in years)	50	48	44	42
Primary school enrolment rate (in %)	44	73.2.	74.3	n.a.
Secondary school enrolment rate (in %)	3.8	10	12	n.a.
Adult illiteracy rate (%)	69.7	49.2.	38.2	33.9

Source: Compiled from World Bank Development Indicators, various

COMPARATIVE PERFORMANCE, 2000

Exhibit: 15

	Uganda	Sub-Saharan Countries	LDCs
Population (million)	22.2	659	2,459
GNI (Atlas method, US$ billion)	6.8	313	1,003
GNI per capita (atlas, US$)	300	480	420
Poverty (% population below national poverty line)	32	n.a.	n.a.
Urban population (% of total)	13	34	32
Infant mortality rate (per 1,000)	97	92	77
Life expectancy (in years)	42	47	59
Access to improve water source (% of population)	52	55	76
Adult illiteracy rate (% of population)	38	38	38
Gross primary enrolment (% school age population)	122	78	96

Source: World Bank

2. INSTITUTIONAL INFRASTRUCTURE

2.1 Political system *(Overall rating 4)*

Since attaining independence from the British in 1962, Uganda has had a dreadful history of violent politics, especially the years under the rule of Milton Obote and Idi Amin who both plundered the country for personal gain[56]. After protracted civil strife, Yoweri Museveni, who had led the National Resistance Movement (NRM), a guerrilla movement against the incumbent governments, assumed power in 1986, introducing a non-political party brand of rule by " a people's movement". In recent years the Movement system has increasingly become a source of controversy between those who advocate multi-party democracy and Museveni supporters who argue that given the country's tribal-related conflict, politics would return them to the days of inter-ethnic and regional conflict.

Some international human rights institutions and domestic commentators therefore give Uganda a poor rating for its political system because the Movement system does not conform to international norms of political participation. On the other hand, it is important to acknowledge that given the post-conflict state of the country in 1986, the centrally-controlled Movement system has gone a long way to developing a cohesive society and allowed the government to pursue very difficult but fruitful economic and social reforms. However, the rating given in this report also takes into account the great lengths the government has gone to in involving the civil society in policy design and implementation and its efforts at decentralised political and fiscal management.

2.1.1 The Rules

At independence, Uganda inherited the Westminster-style of parliamentary system of government, with a federal constitution to facilitate some autonomy for the various districts and kingdoms (there are about 30 major tribal groups) and the first government was a North-

56 See appendix 1 for a chronological history of Political Developments in Uganda.

South alliance. However, this was short-lived, as Milton Obote, the prime minister from the North, with the support of the Northern army seized power in 1966, declaring himself president by suspending the federal constitution. His presidency was essentially a military dictatorship, which lasted until 1971 when Idi Amin ousted him in a military coup. Chaotic rule by dictate and military might ensued for the next 24 years.

In 1986 the National Resistance Army seized power, and installed its leader, Yoweri Museveni as president. For the first nine years, Mr Museveni ruled in a constitutional vacuum under the auspices of the Movement system.

In 1996 a new constitution was promulgated after being drawn up by a Constituent Assembly elected for the task and with broad public consultation. The constitution provided for a maximum of two five-year terms for the presidency. The new legislature comprises 276 members, of whom 214 are elected by universal suffrage, the balance representing interest groups. The members are elected every five years. Under the new constitution, the Movement system was to be retained for at least five years from the 1996 elections, but there was a provision for a referendum in 2000 to determine the nature of the political system. The referendum, scheduled for June 2000, approved that the Movement system be retained for another five years. The constitution provides for a central government, with a network of local governments with both fiscal and political powers "to ensure people's participation and democratic decision-making".

2.1.2 The Structure

Various dictatorships meant that party politics in Uganda never achieved a high level of multiparty democracy.

Party politics

Prior to independence, political parties were along ethnic and religious lines, creating dangerous fault lines, which pre-1986 rulers exploited. The main parties at independence were the Kabaka Yakka (KY), which a Protestant party predominately representing the Baganda peoples; the Uganda People's Congress (UPC) – Obote's party, and the Democratic Party (DP), a mainly Bagandan and Catholic party. The UPC and DP still exist, but have very little coherent identities, as fundamental political ideologies beyond the call for multipartyism do not exist. They also suffer from their linkages to the decades of strife and destruction.

At the height of the instability, new parties emerged, including the left-wing Uganda Patriotic Movement (UPM). After the rigged 80s elections (engineered so that Obote was returned to power), it turned into a rebel opposition forming the National Resistance Army (NRA), led by Yoweri Museveni. The NRA's new political arm was the National Resistance Movement (NRM), which came to power in 1986.

Some smaller parties and organisations were co-opted into the NRM. In both the 1996 and 2001 presidential elections, Museveni won by landslides, as the electorate voted for stability and continuity. However, in 2001 he faced stiff opposition in the urban areas from Kizza Besigye, a retired army colonel and former political commissar of the Movement.

Government

In 1997 the new Parliament passed the Local Government Act, in line with the constitution to give effect to the decentralisation and devolution of functions, powers and services to the local governments. Uganda probably has one of the most decentralised local government systems in Sub-Saharan Africa, characterised by directly elected councils, including the provision of minimum quotas for women, youth, and disabled, and which are corporate, autonomous bodies, which can enact local legislation, raise revenue, manage funds, enter into contracts, employ staff, sue and be sued, and be held legally accountable. The Act establishes the hierarchical structure of local governments as follows:

- District Local Council –LCV
- Municipality/County Council – LCIV
- Sub-county/Town Council – LCIII
- Parish Level – LCII
- Village Council - LCI

2.1.3 Management

The Ministry of Finance, Planning and Economic Development (MoF) is the primary economic institution in Uganda; with a highly effective management team that successfully designs and implements economic policies and strategies.

Instability and dictatorships have marked Uganda's politics since independence. Eight changes of government occurred between 1962 and 1986, four of them achieved by military force. Since then, despite the continuing civil strife in the North between government forces and the Koni rebel group, Uganda has known internal stability over the last 16 years. Uganda has also been involved in regional warfare, which has largely been supported at home and, more importantly, has not caused upheaval at home[57].

Nowadays, political stability is largely due to the dominance of the Movement system, whose central tenet is providing for individuals to contest elections under the NRM umbrella[58]. President Museveni's government has dramatically evolved over the past 16 years from its early stance of pro-socialism marked by a strident rejection of market-based reforms (1986), followed by reluctant implementation of reforms (1987-92) to the current full ownership of such reforms. This evolution in economic policy matters has not been translated to the political sphere. Although President Museveni has since embraced a contested electoral system (he was formally elected president in 1996, and again in 2001) he has retained the Movement politics and not introduced multiparty politics. There is ongoing debate both inside and outside Uganda on the efficacy of this system of politics and the level of democracy it affords Ugandans.

Institutional effectiveness at the political level varies between institutions, with the MoF exhibiting the most effective management of both financial and human resources. The ministry is so consistently good at policy design and management because of competent leadership that the country's Poverty Reduction Strategy Paper programmes are used by the World Bank as best practice for other IDA countries. Closely tied to this is the public and concerted political commitment of the President and his government to economic policies and reforms that encourage growth and the reallocation of expenditures to the social sectors aimed at reducing absolute poverty in Uganda. Parliamentary debate is vigorous and widely reported in the local media. Yet, serious weaknesses are apparent in tax administration (see 2.4.3) and line ministries (see Decentralisation).

The politicisation of the electorate and conduct of political institutions (at central and local government levels) have been one of the main focuses of development for the government, donors and NGOs. In the annual budget, financial resources for constitutional and political reform and management are provided for under the Public Administration sector (appendix 3). The Public Administration's percentage share of the Budget (excluding contingencies) dropped from FY1999/00 (refer to appendix) to 18.7% in

57 Between September 1996 and May 1997 the Ugandan army joined forces with neighbouring Rwanda to assist militarily in the overthrow of Mobuto Sese Seko of another neighbouring country, Zaire. In August 1998, Uganda and Rwanda began supporting a rebel coalition against the new regime in Zaire, now Democratic Republic of Congo, before the two allies fell out and clashed in August 1999.

58 i.e. Members of Parliament and the president are elected in their own right not on ideological grounds or tribal political affiliations.

FY2000/01, while the sector's share of outturn (i.e. actual release for funds) was higher in FY2000/01 (at 21.2%) than in the FY1999/00. The government notes that the fact that the actual share of resources to this sector has increased (irrespective of the Budget intentions to reduce expenditure) is a matter of "serious concern". The reason for the over-spend in funding included financing for the Electoral Commission, Parliament and Mass Mobilisation, much of this relating to both presidential and parliamentary elections of 2001. Of positive note is that the over-runs on expenditure in this sector were directed towards development, not wage increases.

At the local government level, there is recognition by the central government and donors of a lack of human resource capacity. Currently, decentralization offers a big challenge, aiming to transform the system of local governance by progressively delegating planning and decision-making to district, sub-county and community level and hence enabling local communities and institutions to take responsibility for the management and development of their economic, social and natural environment[59].

A World Bank-supported project – the Local Government Development Programme (1999-2003) – was introduced to improve the delivery of basic services to engender economic growth and poverty reduction within the framework of the government's decentralisation policy. To effectively address the major constraints currently retarding effective decentralisation, the project's objectives are:

- To test the feasibility of implementing constitutional and legal mandates with respect to decentralised service provision and devolution of the development budget.
- To build the capacity of the line ministries and local government departments for improved service delivery, accountability and transparency.
- To introduce and test alternative service delivery mechanisms through private sector, beneficiary communities and other stakeholders in Kampala City Council.
- To monitor and evaluate project implementation for actual experience and good practices for formulating appropriate strategy, implementation modalities and phasing for eventual scaling up nationally, over time.

There is need for urgent assistance in the strengthening of financial management capacity of local governments to enable them to meet the MoF's minimum requirements to be eligible for the non-sector conditional grant funding. A review of annual Budget allocation and utilisation in FY2000/01 reveals that some local governments failed to draw down on conditional grant transfers because of non-submission of quarterly work plans, budget requests and progress reports – all pre-requisites for access to PAF funds.

Aid management

From the early 90s the Ministry of Finance has been effectively mobilising and managing development aid and it is highly rated by donors and Ugandan economic partners. Within the ministry, the Budget Department, Aid Liaison Department and the Economic Development Policy and Research Department all work very closely with the Bank of Uganda in structuring macroeconomic policies and assessing deliverables under priorities set in conjunction with line ministries, donors, civil society organisations, non-governmental organisations, and the private sector.

In particular, the Aid Liaison Department has a central aid co-ordination role, where formerly five government units in different ministries managed aid mobilisation and disbursement. In 1995 parliament passed an External Loans Act that authorised only the MoF to mobilise foreign borrowings for public expenditure by the government. The ministry manages aid through periodic formal meetings with donors on the economy's progress, thematic issues, aid needs, debt relief, the annual budget process, and the Poverty Action Fund (PAF)[60]. The ministry also has responsibility to manage the consultative process with line ministries, the private sector and civil society organisations – this process identifies priorities and assists in efficient and effective allocation of resources.

Unfortunately, as mentioned above, its capacity to deliver a high level, skilled, core group of technocrats is not shared at line ministry and district level, which has led to concerns about effective absorption of financial resources (including aid) at that level. The major constraint has been weak capacity because of the slow progress of public sector reform (outside the MoF). There are difficulties in recruiting, retaining and motivating staff, reflecting the gap between remuneration in the public service and elsewhere.

As part of its economic framework, the government has set up monitoring structures to assist in measuring progress and for accountability and transparency towards both the donor community and the electorate. At the macroeconomic level, there is the Annual Public Expenditure review (published in May) and the Budget Performance Report (semi-annual). Semi-annual reviews on key sectors are published (October and April), and the review process involves approximately 100 donors, civil society organisations, academics and practitioners who all participate openly. Health and education have the most established reviews, since 1998, with similar plans in place since 2001 for water, roads, and justice, law and order.

2.2 Legal Framework [61]
(Overall rating 2)

The rule of law creates an environment in which social, political and economic development can flourish. Consequently both the government and the donors have prioritised the need to strengthen the legal framework largely because of Uganda's post-conflict status. The development progress between 1986 and the mid-90s was achieved from a very low base, and for economic growth to be sustainable effective and enforceable laws are required to govern the conduct of business both in the public and private sectors, as well as to afford participants in the economy with security.

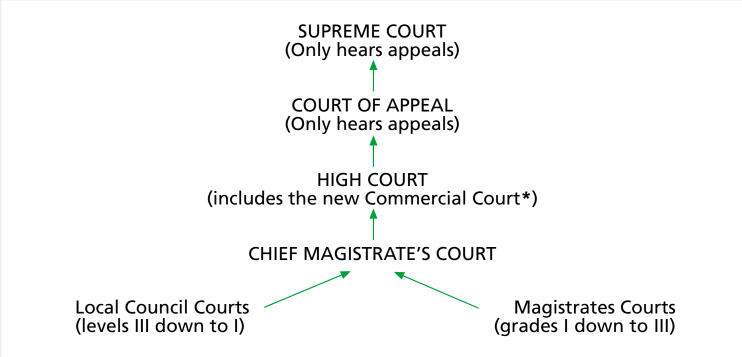
2.2.1 The Rules

The government, with concerted support from the donors, has been overhauling the weak legal framework, to make the laws and procedures more appropriate for a rapidly growing economy. In July 1999 the government, with support from donor funds, carried out a commercial justice study, which concluded that the malfunctioning commercial justice system adversely affected economic growth in Uganda. Both criminal justice and commercial justice are priority sectors as part of the sector-wide approach. Though this priority was formalised by the Law and Order Sectors' draft Budget Framework paper, 26 November 1999, the situation has not improved much since that report. The inability to enforce contracts and collect debts, due to backlogs in commercial law suits, inefficiencies in the civil registries, corruption and a lack of specialisation in commercial law practices, has precipitated losses to the government by approximately 2% of GDP. The Advocates Act, for example, still prohibits (amendments being considered in Parliament) foreign advocates from practising in Uganda, severely limiting competition and preventing Uganda benefiting from experienced international lawyers.

59 Local governments are responsible for provision of all basic services: primary and secondary education, primary health and district hospitals, water, sanitation, rural roads and agriculture. Central government retains role in policy issues, standard setting and monitoring.
60 PAF is made up of savings resulting from Uganda's access to debt relief under the Highly Indebted Poor Countries (HIPC) Initiative.
61 Focus in this section is on Commercial Legal Framework. Criminal legislation and the police are referred to under Governance.

UGANDA COURT SYSTEM

Exhibit: 16



2.2.2 The Structure

Uganda's court system comprises the Supreme Court, which is the highest authority, the court of Appeal, the High court and the Chief Magistrate's court, which includes Local council courts and Magistrates courts (see exhibit 16).

Uganda's commercial courts comprise the Magistrates Courts, which are responsible for claims of US$5 million or less, the Commercial Division of the High Court, the Industrial Court under the auspices of the Ministry of Labour for the settlement of trade disputes, and the Centre for Alternative Dispute Resolution (CADER). The Commercial Division of the High Court was widely welcomed by local business when it was established in 1996, with the objective of delivering an efficient, expeditious and cost-effective mode of adjudicating disputes that directly affect economic, commercial and financial life in Uganda. The establishment of CADER in 1998 was also well received. The intention was to provide an alternative dispute resolution mechanism to the commercial courts. Both institutions have yet to achieve their intended core objectives. Success of CADER for instance is to some extent ultimately dependent on the Commercial Court's effectiveness, as the latter has to enforce its awards.

2.2.3 Management

Whilst progress in amending legislation to update the legal framework has been made, major problems with the operation and administration of commercial courts, commercial registries (Land Registry and Companies) and commercial lawyers remain. The one Commercial Court is understaffed and is dealing with an immense backlog. Several studies have also shown that Ugandans have a limited understanding of commercial laws, a possible result of a deeper dissatisfaction with the lack of access to commercial justice due to the cost of the service.

A critical problem continues to be the lack of a debt repayment culture among businesses and individuals, which is compounded by the fact that debts are not always in practice enforced through the court system. The problems in the Magistrates and Commercial Court have been summarised in the Legal Sector Programme Study as "delays, unpredictability, inefficiency, absence of modern technology, poor library and research facilities, poor management skills in case-handling and record-keeping. Few judges and magistrates have specialised experience and skills in business and commercial law matters." In addition to this is the perception that corruption amongst judiciary staff is rife. All these problems make secured commercial business transactions difficult and uncertain, further damaging the fledgling private sector and discouraging credit support from the financial sector.

One of the banks' major complaints being the lack of collateral, the inadequacies of the Land and Companies Registries require urgent attention. To that end, in line with the government's broader divestiture policy, the registries will become agencies (presently departments of the ministry of Justice), and together with technical assistance, an action plan for the institutional reform of each registry is being drawn up as part of the overall commercial justice reform strategy. In 2000, the total reform programme was budgeted to be about US$8 million over FY2000/01 and 2001/02. An Implementation Support Unit has been set up in the Ministry of Justice with responsibility for promoting and managing the programme, as well as co-ordinating donor assistance.

Capacity-building programmes have been instituted, with the training of lawyers in commercial law at the forefront. There has also been concerted effort to instil effective management of support staff in terms of selection, appointment, training, promotion and discipline. To deal with the lack of professional ethics amongst advocates, a major bottleneck, the Advocates Act is being amended to strengthen the Law Council's disciplinary committee and establish a firm code of conduct for the legal sector. To date there have been reports of marginal improvements, with the banking sector for instance drawing comfort from the knowledge that some of the defaulting creditors are being brought to account.

If the commercial justice reform is to be successful, government and donors will have to provide more targeted financial resources and technical assistance to the efficient management of this important sector. The wider justice, law and order sector (excluding security/defence) has seen its budget allocation decline over the years, though clearly the higher amounts provided up until the mid-90s were inefficiently utilised. Even after the government prioritised the sector, Budget allocation continued to decrease, with the sector having 6.9% of the annual Budget allocated to it in FY1999/00, falling again to 6.3% in FY2000/01. The sector receives funding directly from donors in specific donor grants, with the World Bank and the Austrian Government financing the Uganda law Reform Commission.

2.3 Financial System
(Overall rating 4)

Uganda's small financial system is highly oligopolostic, inefficient in performing many basic banking functions, with a commercial banking sector that is dominated by foreign-controlled international banks[62] primarily interested in the upper end of the small corporate market, leaving a significant population unbanked.

2.3.1 The Rules

At the apex of the financial system is the Bank of Uganda (BOU), one of the few central banks in Africa with central bank independence from political interference invested in it by the country's Constitution (1995). The BOU was established in August 1966 under the Bank of Uganda Act of the same year and amended in 1969 and 1993. Its operations and those of the financial system are also provided for by the Financial Institutions Act of 1993, which rectified most of the legislative defects in the banking system such as:

- Granting BOU authority to licence banks (previously with the minister of finance and thus open to political manipulation)
- Granting BOU authority to act on prudential measures, without prior MoF approval

62 Barclays, Standard Chartered (both UK-owned), Stanbic (part Standard Bank of South Africa Group), and Citibank (of the USA).

- Authority to issue statutory instruments to revise capital requirements to enable adjustments accounting for inflation, and specify minimum ratios for core capital and total capital to risk-adjusted assets of 4% and 8% respectively, in line with the BASLE accord on capital adequacy
- Introducing flexibility into how the BOU implements prudential requirements, without recourse to courts
- Granting BOU oversight responsibility for all credit institutions, building societies and development finance institutions, bringing all financial institutions under one supervisory authority

The 1993 Act is to be replaced and a new bill presently in Parliament aims at further strengthening the central bank's independence by giving the BOU mandatory and prompt powers to intervene and act in cases of insolvent banks. The new statute will also provide for comprehensive provisions to govern insider dealing, corporate governance, credit concentration (in lending institutions), and limit sole ownership holdings. The latter amendments are aimed at rectifying the problems which have dogged the Ugandan financial system since 1991, the latest being the closure of three locally owned banks in 2000-01.

2.3.2 The Structure

Uganda's financial system is dominated by a thin and small banking sector where commercial banks account for 80% of total sector assets. The financial system in Uganda consists of 17 commercial banks, six non-bank credit institutions, three development banks, one post office savings bank, approximately 450 cooperative savings and credit societies, 35 micro finance institutions, 18 insurance companies and 13 securities brokers and dealers.

The four largest commercial banks in Uganda, all of which are foreign-owned, account for 74% of total sector assets. The commercial banks have limited outreach into the country via branch networks, with the exception of Uganda Commercial Bank (67 branches) and the Cooperative Bank (24 branches). Stanbic now owns 80% of UCB, making the South African bank Uganda's largest countrywide retail bank. Stanbic plans a legal merger with UCB, and will commence the rollout of some of its successful products and services tested in the South African retail market.

The micro finance institutions (MFIs) have proliferated in recent years and are unsupervised. These provide short-term loans to groups of individuals in small towns and organized communities in rural areas. Most of these are operated on a non-profit basis by donor agencies. The government and donors are investigating ways of establishing a regulatory framework, which will enable MFIs to progressively evolve into financial intermediaries without compromising the stability of the entire financial system.

The development of a capital market is still in its infancy. Only four companies are listed on the stock exchange, and the market is very thin with very little trading. It is the government's plan to float the shareholdings it retains in some of the privatised companies (including banks[63]) on the stock market.

2.3.3 Management

One of Uganda's financial strengths is the Bank of Uganda (BOU), which in recent years has achieved a strong regulatory and supervisory system without political interference.

Financial reforms

Since 1987, the government has been implementing financial sector reforms to correct the repressive control policies of the pre-Museveni government when negative real returns on monetary assets contributed to the steep decline in the financial depth of the Ugandan economy. Between 1970 and 1990 the M2/GDP ratio fell from 18% to 7%, while the share of bank deposits in M2 decreased from 65% to 59%. Public confidence in the banking system was further undermined by the demonetisation exercise in 1987, which imposed a tax of 30% on holdings of currency and bank deposits as well as other financial assets in a crude attempt to reduce liquidity in the economy.

By 1991, in line with the government's change in economic policy, reforms were introduced under the World Bank and IMF programmes, including the liberalisation of interest rates, removal of credit restructuring distressed state-owned banks and strengthening prudential regulation. Recent regulatory and supervision reforms have paid off, instilling discipline and soundness to the Ugandan financial system. However, some weaknesses remain and need urgent attention. These include the structural realignment of the system to support development within the country's current and future economic development needs.

The Bank of Uganda

In general the reforms post-1991 have yielded some positive results. The BOU now indirectly manages interest rates and the money supply, primarily through open market operations involving the issuance of Treasury Bills (TBills). The central bank effectively uses its independence (enshrined in the Constitution) and is in sole charge of monetary policy, with decisions made by the Monetary and Credit Policy Committee. That there is no political interference from MoF or the President's office in monetary policies is most impressive given the sensitivity of Uganda's monetary management, which has inherent inflationary tendencies. Donors fund 53% of the national annual Budget, and the bulk of the draw downs of these funds is for social sectors under the PEAP, making the local money market continuously flooded with Shillings. Despite this, Uganda has managed single digit inflation over the last few years by actively intervening in the market to mop up excess liquidity by issuing TBills[64]. The BOU is aware that its monetary management has long-term shortcomings (see below).

The implementation of these legislative changes together with the reorganisation of the BOU has led to a strong supervisory and regulatory capacity in the central bank, with the closure of insolvent banks. The Bank Supervision Department has been reorganised into two divisions, one dealing with commercial banks and the other with non-banking financial institutions. Both divisions have received substantial funding to enhance the skills-base of supervisors, with international advisers recruited, local staff sent abroad for intensive training and new technology purchased[65]. The submission of regular information from financial institutions to the BOU has improved and on-site inspections are being undertaken. The improved calibre of the supervisors is acknowledged by the banking industry, the important players being foreign-owned banks which have to adhere to international standards.

The cleaning up of the distressed banking industry from 1994 is evidence that a combination of the BOU using its statutory powers and strong management leadership (at Governor level) have enabled the central bank to adopt a more purposeful approach to prudential regulation. Illiquid banks no longer receive automatic overdraft facilities from the BOU. Insolvent banks have either been closed or brought under BOU administration for restructuring before new investors take them over. Given that this tough stance has affected the weak, small, local, privately-owned banks and the restructuring of state-owned banks, the integrity and resolve of the BOU management has been commendable.

63 Government retains minority shareholding in Bank of Baroda, Barclays, Stanbic-UCB.
64 Unlike in most African countries (e.g. Kenya, Zimbabwe) TBills are used as a monetary management mechanism, NOT to raise borrowings for the government.
65 In 1999 the department had 10 foreign consultants and advisors, but through a capacity training scheme only 3 remain, the rest being Ugandan graduates trained on the job or abroad.

The current BOU governor has a strong and reputable management capacity acknowledged beyond Uganda. The Oxford-educated governor is Uganda's former permanent secretary of the MoF, and is one of the architects of the country's highly commended PEAP and related economic policies. He and his skilled team are an integral part of the economic core of technocrats that have consistently developed policies for the country and advised the President, and can be credited with the significant economic growth the country has experienced since the 90s including the marked reduction in absolute poverty. It is important to note that the corollary of this is high dependence on a technocratic elite.

Although the largest commercial bank (and the bank of most rural people) has been restructured and privatised, the government and the BOU have insisted on the retention of a sizeable number of rural branches. In February 2002 the Central Bank sold 80% of UCB with full management control to Stanbic of South Africa. The BOU insisted that the sale was conditional on Stanbic retaining all 67 branches of UCB until 2004, and thereafter at least 47 branches (the majority in rural districts) would not be closed. This is in line with the central bank's aim to extend valued financial services to Ugandans across the country, and ties in with the government's poverty alleviation economic programmes aimed at providing vital services to rural farmers.

The BOU acknowledges that it has a limited range of investment instruments on offer – its longest TBill is 365 days – further exacerbating the non-existent long-term lending market required for productive development. There is also no discernable market in corporate paper (though the South African telecommunications company, MTN, recently issued a corporate bond which was reasonably subscribed). The BOU would want to see long-term government bonds introduced to increase financial deepening and encourage private sector development, but the MoF is hesitant. The ministry argues that at present, the bulk of development is in social sectors and utilities (as opposed to the productive sector), which are in the realm of the public sector. Because these programmes have a large foreign currency component, Shilling-denominated bonds would not be cost-effective. Moreover, in the short- to medium term, using the available donor funds (primarily grants) is in line with the government's policy of prudent debt-management as bonds would see domestic borrowing soar. While this argument holds in the short term, Uganda must prepare for long-term strategies aimed at strengthening private sector development and a sustainable financial system.

The financial system

Despite the above measures and focused management, financial weakness in some banks, the lack of an effective exit mechanism for insolvent institutions, segmentation within the financial sector limiting competition, asymmetric information, and lack of capacity to effectively supervise a liberalised banking sector have posed major constraints on the development of the financial sector.

Furthermore, The Ugandan financial system plays a limited role in financing investment and growth, with the outstanding stock of loans only one-half of the external grants and loans. Domestic credit by the banking sector as a percentage of GDP fell from 17.8% in 1990 to 7.5% in 1999. Other specific issues are:

- High lending interest rates despite the low level of deposit rates, the Bank rate, the Rediscount rate and the TBill yield
- The dearth of long term financing by the commercial banks
- Lack of access to credit by micro-finance institutions (MFIs)
- Lack of collateral for bank loans by small and medium enterprises (SMEs)
- The prime source of bank balance sheet growth in financing domestic investment, the foreign currency deposits, have been invested abroad or in TBills

Very low penetration into the rural area, when 89% of Uganda's population is rural. The bulk of corporate private sector credit is concentrated in the Kampala urban area.

Regarding the provision of credit to micro enterprises and SMEs, the government has to date taken the lead through programmes such as Entandikwa Credit Scheme (Entandikwa) and District Development Programmes (DPPs). In 1999 the government's share of credit was 20.6%, with NGOs providing 16.2% and banks (5.2%). Relatives and friends provided the largest share of credit (54.7%). As part of prudent economic management, in the medium term the government plans to divest itself from the direct delivery of credit. Although there are some MFIs (mostly registered as NGOs or companies limited by guarantee), there remains a vacuum in the financing of this type of business. While access to credit from the formal banking sector continues to restrict the development of MFIs, the more worrying constraint is that the public often regards the current delivery systems as grants and therefore not repayable. Both the Entandikwa and DPP programmes have not established accountability on the part of borrowers, while the NGO-based MFIs have a very weak contract enforcement framework. Current discussions to reform this sector include converting the Entandikwa into a credit line for MFIs for on-lending purposes, as well as encouraging donors to similarly channel credit (i.e. as opposed to giving NGOs and/or MFIs grants).

The development of the productive private sector has been lagging far behind all the other sectors because of a combination of factors, including the structure of the Ugandan economy (predominantly small scale private subsistence farming), limited access to financial resources, crippling transport costs, a weak (poor) domestic market, the lack of a culture of entrepreneurship, and the legacy of years of civil conflict. The sector has therefore been unable to effectively absorb available financial resources. To redress this, there is an urgent need to improve corporate governance.

Some of these problems are symptomatic of structural problems within the banking system. One of the main reasons for banks' risk aversion is the industry's history of accumulating huge non-performing assets as a result of previously poor economic performance and the pervading culture of non-payment of obligations (see Corporate Governance). Banks prefer to invest in safe government securities, and until mid-2000 the TBill rate of an average 20% was more lucrative than lending rates. The TBill rate has in the last six months dropped to an average of 2.7%, and the money market is extremely liquid, but banks remain shy of taking on risky loans.

To compound the risk-aversion among banks, the general Ugandan population has little confidence in the banking system. The population recalls the era when private banks were nationalised and recently when bank collapses (and thus loss of savings) where endemic. According to the EIU (2002), the establishment of a sound financial system has been slow and corruption is still rife, especially in the small indigenous banks and in the general conduct of business. Because the market is very thin, real competition between the institutions is minimal - commercial bank entry is restricted by the requirement that new banks must offer new financial products – and banks are often seen to act as a cartel.

Both the MoF and BOU are pushing for the opening up of the pension market as a first step to creating a viable secondary market. The country is characterised by low domestic savings, and this is exacerbated by the poorly managed National Social Security Fund, a government-owned monopoly that continues to invest in short-term assets rather than in long-term stocks and bonds that would contribute to the availability of badly needed long-term-capital.

2.4 Corporate Governance *(Overall rating 1)*

Uganda does not have a history or culture of good governance, meaning that there is a tremendous amount of work to be done to bring it in line with international best practices. Corporate governance has the lowest score both at institutional infrastructure and management levels. This has been and continues to be an immense constraint to economic and social development as it limits the effective absorption of financial resources. That the President has a rather circumspect definition of corruption has not been of much help. For him, Uganda has moved on from the corrupt regimes of his predecessors who resorted to officially sanctioned torture of the population and indiscriminate systemic plunder of national treasures by a privileged elite. He sees what is taking place in Uganda today as administrative misappropriations orchestrated by a few people taking advantage of a malfunctioning system. The donors appeared not to have pressed on this issue until in recent years when corporate governance has been included as financial assistance conditionality by both multilateral and bilateral donors.

2.4.1 The Rules

The legal framework providing for basic governance exists, but needs strengthening in line with the OECD principles of corporate governance. However, legislation covering company and investment laws and procedures has recently been streamlined. A new Investment Code Act (1991) replaced the Foreign Investment Act (1977) and the Industrial Licensing Act (1969) has been abolished.

2.4.2 The Structure

The administration of governance is weak because the institutions and management do not effectively deliver good governance. Unlike political governance, which has been part of financial assistance conditionality for some years, the donors have not until the last two years put much explicit emphasis on corporate governance. For instance, the Ministry of Ethics & Integrity does not as yet address corporate governance. Whilst the private sector lobby groups are not yet well organised, since 1987, a few institutions and organisations have become active in the policy dialogue with the government to strengthen commercial jurisdiction, reinforce property rights and facilitate the settlement of business disputes. Of note has been Parliament, the independent Economic Policy Research Centre at Makerere University, the Uganda Manufacturers Association, the Private Sector Foundation, NGOs (mainly under the auspices of the Uganda Debt Network), and to a lesser extent the National Organisation of Trade Unions and the Uganda Farmers Association.

In 1991, the Uganda Investment Authority was created to administer the new investment code, and also act as a one-stop investment centre for investors. To re-dress the effects of wholesale nationalisation and confiscation of Indian Ugandans' property and reaffirm the government's respect for private property, the Departed Asians Property Custodian Board was established.

2.4.3 Management

Corporate governance in Uganda is still in its infancy at both the private sector and government levels.

Private sector

The five basic aspects of the OECD corporate governance principles are not widely adhered to in Uganda, though they are provided for by legislation. According to the UNDP, an enormous gulf exists between the legal framework and how businesses are structured and operated. They advise largely small and medium enterprises and sole traders, who apparently lack knowledge on the different roles of stakeholders, responsibilities of board of directors, rights of shareholders and the equitable treatment of shareholders. The bulk of the small businesses are formed as partnerships without clarification of these rules, leading to company collapses. Memorandums of Articles are routinely vague and not understood or complied with. Of interest were reports that business people preferred to resort to "African custom" of consensus mediation to resolve business disagreements instead of the formal rules and regulations of company management.

Presently, Uganda Enterprise is lobbying for a simplified version of company law, as the first step towards developing an appreciation of the validity and importance of the country's commercial laws. This is all the more relevant given that traditionally most enterprises in Uganda commence as informal operations outside both the legal framework and formal monetary sector.

Further to the widespread lack of understanding that businesses are legal entities, which must operate within a prescribed legal framework, the country has limited professional bodies to provide objective and independent advice and uphold standards in commercial activities. The four international accountancy firms are represented by subsidiaries, but provide services exclusively to the top corporations, financial institutions and the government, leaving SMEs and sole traders to the unskilled, inexperienced and very few accountants. Enterprise Uganda, the Private Sector Foundation, and numerous NGOs (in particular Veco-Uganda) have been valiantly trying to provide advisory services to enterprises in basic bookkeeping, accounts management, preparation of business plans, procurement procedures and human resource management.

A credit rating bureau, a ratings agency and a regulatory body for financial accounting and auditing would all improve transparency and disclosure. At present banks are legally prohibited to provide the information required for a credible credit rating bureau to operate effectively. There have been no plans to establish a ratings agency at all. The need for a robust accounting and auditing institution is paramount given the weakness of the tax administration.

The aversion to transparency and disclosure has in particular affected the development of the stock market, which requires evidence of financial viability over a four-year track record. Companies are either not in position of adequately audited financials or are loathe to produce the ones they have for fear of being liable to unpaid taxes (the URA has authority to investigate individual and corporate taxation issues retrospectively for up to 40 years).

The Government

The Uganda Revenue Authority's (URA) capacity to deliver is cited by both the private sector and the government as a major impediment to investment and growth. A survey in 2001 by the East African Association cited unequal treatment by the URA in processing refunds, fraud, lack of understanding of the laws, delays in agreeing on previous years' tax positions, smuggling and dumping as key constraints to private sector development. Measures to deal with corruption in tax collection include steps to operationalise the Tax Appeals Tribunal. To combat the general lack of discipline and corruption in procurement operations, the government has made arrangements with the International Trade Centre UNCTAD/WTO to provide specialised training in ethical procurement norms to complement training being provided by the Swiss Procurement Company (SWIPCO).

The laudable economic growth rates in Uganda have not translated into comparatively increased levels of government revenue, which remain under 12% of GDP because of a combination of institutional problems (particularly inadequate staff incentives) and the sheer absence of public awareness on taxation issues. While agriculture comprises 40% of GDP, the bulk of this production is non-taxable because it is from subsistence farming which is outside the formal monetary system. Of more concern for tax administrators is that existing legislation, such as the Finance Statute, are too complex for ordinary taxpayers to comprehend. This leaves taxpayers ignorant of tax policy, tax structure and their taxation rights, and hence vulnerable to a non-transparent tax system. Those who have been targeted by education programmes have tended to use the knowledge to avoid their tax obligations.

Private sector organisations have been more inclined to provide resources to macro-economic policy formulation than to focus on managing the processes to enhance corporate governance within itself. Thus the Uganda Manufacturing Association (UMA) has developed a strong partnership with the government in policy formulation, beginning with its leadership in 1991 in creating the Presidential Forum. The association participates in the annual Budget process and in determining the speed and sequencing of the trade reform programme. The Chamber of Commerce and Industry is not as active in direct lobbying, though it has some political influence through members of Parliament. Farmers, on the other hand, are barely active in policy dialogue because they are less organised. This is despite the IDA-funded Agricultural Secretariat in the BOU charged with spearheading agricultural sector reform under the government's Plan for Modernisation of Agriculture (PMA). The secretariat has provided resident advisers, while consultants were provided by the UN Food and Agriculture Organisation and the World Bank. The secretariat has been credited with restructuring both the coffee and cotton sub-sectors, and is working at land reform.

Overall, given the nascent development stage of the private sector in general, and that Uganda only began functioning as a 'normal' state in 1986, there have been some notable successes in the participation of various groups representing interests in the private sector contributing to the design and implementation of policies to improve corporate governance. In particular, the contribution of the Departed Asians Property Custodian Board in efforts to re-introduce trust in property rights are commendable. By 1994 the Board had overseen the verification of 640 out of 690 claims by non-citizens and 1,860 out of 2,000 claims by citizens and property returned to the original owners. This process had been cleared by 1996, a remarkable achievement on the part of government. It is important to note that this programme benefited from the large role played by donor-funded technical assistance, and demonstrated the government's political will at the highest level.

Parliament has acted as a useful instrument and watchdog, and has been especially active in the field of privatisation and exposing cases of corruption, leading to the impeachment or dismissal of some ministers. This has resulted in greater transparency and accountability in public administration, which is slowly being emulated in the private sector.

2.5 Trade and Competition *(Overall rating 3)*

2.5.1 The Rules

Trade liberalisation has been central to Uganda's structural reform process, commencing in the late 80s. The Museveni government recognised the urgency of reversing the trade policies of the 70s and early 80s characterised by export taxation, quantitative restrictions on imports, extensive non-tariff barriers, biased government purchasing, and considerable smuggling. By 1999 the tariff system had been rationalised, giving Uganda one of the lowest tariff structures in Africa.

In 1991 the government conformed to Article VIII of the IMF, stipulating that no restrictions be placed on international transactions. In 1993 the foreign exchange auction was replaced with a market-determined foreign exchange system. In addition, in 1997, the capital account of the balance of payments was opened up to increase private capital flows.

Uganda is a member of various international and regional trade organisations, including the WTO (January 1995), the Preferential Trade Area (PTA) for Eastern and Southern Africa, and the Common Market for East and Southern Africa (COMESA). Duties and tariffs for members of the regional organisations are significantly lower than duties for non-members. Also, Uganda, Kenya and Tanzania a have formed the East African Co-operation Secretariat, a forerunner to the planned the East Africa Community.

2.5.2 and 2.5.3 The Structure and Management

Lack of infrastructure, difficult access to export finance, strengthening trade links and improving governance are key areas for Uganda to focus in order to improve trade management.

Despite the numerous policy initiatives to encourage exports since 1986, the country has run trade deficits for the last 15 years. Various factors have contributed to this – concentration on coffee exports, volatile prices of primary commodities, fluctuations in demand for said commodities, susceptibility of production output to bad weather and rising levels of imports, especially rising oil prices.

The challenge for Uganda is to stem the deterioration of terms of trade, attain trade surpluses and diversify the export base. In 1991 the government established the Export Refinance Scheme (ERS) aimed at diversifying the country's export base by encouraging the growth of non-traditional exports. The scheme was envisaged to provide medium-term discount facilities to refinance bank lending to the export sector with a Bank of Uganda guarantee. Unfortunately liquidity constraints limited the scheme to a short-term discount facility, failing in its primary objective. Other factors contributing to its demise included inadequate (fixed) interest margins perceived as unattractive by the banks, lengthy processing time at the BOU (especially discouraging exporters of perishables), and excessive collateral required by banks. The USAID and the BOU funded a review of the scheme, leading to its re-launch as the Export Refinancing Facility (ERF) in 1997. This has since been incorporated into the BOU's Export Credit Guarantee Scheme (ECGS), which offers a measure of assurance to commercial banks to lend to exporters of non-traditional exports including those without collateral. The Export Promotion Fund (EPF), launched in 1998 with the primary objective to ensure that sufficient credit resources are available to support non-traditional exports, complements the ECGS. Uganda is a participant in the Regional Trade Facilitation Project (RTFP), which is a COMESA-led initiative funded by the World Bank to cover political risk for both export and import transactions.

Despite these initiatives, Uganda's export performance remains constrained, whilst the import bill continues to escalate. The reasons for the failure to take advantage of available external markets include the inadequacies of the country's infrastructure (particularly transport, given Uganda's landlocked situation), of facilitating easy access to finance, strengthening regional trade links, improving governance and reducing corruption. The export finance facilities are not easily accessible and many exporters are ignorant of their existence. The institutional framework for export development does not appear to provide adequate and efficient market information to exporters. Government and donor surveys also indicate that a large number of current and potential exporters are unaware of available export incentives[66].

Specific to traditional agricultural exports, the country needs to:

66 A Bank of Uganda survey (1998) indicated that only 55% and 60% respectively were aware of the Duty Drawback System and trade finance facilities provided via the banking system.

- Strengthen and support quality standards and regulations regarding exports to assure buyers of the quality of the products
- Strengthen crop regulatory authorities so that they can assure that quality standards are met and long-term sectoral growth and sustainability are achieved
- Support dedicated research programmes to introduce appropriate technology and protection against pests and diseases
- Develop and promote an image of quality in foreign markets, aimed at increasing demand and achieve premium foreign markets
- Pursue possibilities for moving up the value added chain - Uganda's share of world coffee production is only 3% and over 90% of the country's cotton exports are in raw form, meaning that the country is a price-taker on the international market.

There is potential for growth in the non-traditional sector, for example, Uganda's share of Sweetheart Roses at the BVH Auction in Holland is only 1%, compared to Kenya's 14%. If Uganda were to increase its share to 7%, this would cost approximately US$135 million in new investments and would generate an additional US$90 million per year in export earnings (World Bank, 2001). The country also has the potential to tap into the export of electricity – with large demand from its larger neighbour, Kenya. There is budding growth in exports of ICT services, with at least three companies now providing accounting services to North American corporations.

Uganda's tax system remains heavily reliant on international trade, making it prone to external shocks. Customs duty alone contributes about 30% of the total tax revenue. This said the country has a comparative tax disadvantage in tourism and manufacturing vis-à-vis its neighbours[67]. Some of this can be explained by the higher transportation and marketing costs due to the poor infrastructure (particularly relevant to fuel imports). The government has committed to harmonising fuel taxes with those in Kenya, and to enhance Uganda's competitiveness in tourism and manufacturing in the context of the planned East African Community.

In principle, exporters have access to VAT refunds and duty drawback, but refund mechanisms are characterised by long delays in reimbursements, frequent disputes in drawbacks applications, temporary shortages of funds to make drawback payments, exclusion of indirect import-related import taxes and a lack of awareness of the drawback scheme by potential beneficiaries. In a recent study, the government, in collaboration with the World Bank, recommended the introduction of two schemes to support the Individual Duty Drawback system; (a) a Fixed Duty Drawback Scheme (which lays a foundation for the international best practice for exporters in conformity with the WTO requirements), and (b) a Manufacturing Bonded Warehouse (which will meet the immediate need of the 100% export firms).

Given the small domestic market (in terms of low purchasing power), regional and international cooperation is an important part of Uganda's export promotion strategy. Participation in these trade organisations reflects Uganda's commitment to the promotion of open and liberal trade policies as a component of development and poverty reduction strategies. However, due to resource and capacity constraints prevalent across the economy, little attention has been paid to the linkages between these strategies and trade reform. A starting point could be the streamlining of the management of trade issues. For instance, the ministry of finance handles the issues pertaining to the Lomé Convention, while the ministry of foreign affairs handles those pertaining to the East African Community. COMESA and the WTO issues are the responsibility of trade and industry. Even more importantly, trade policy design and implementation ought to be more pro-poor and supportive of sustainable development. To date, trade policy processes exclude various stakeholders such as small-scale operators, producers and the marginalized social groups.

3. CONCLUSIONS

The effective use of aid together with the structural economic reforms have turned the core economic institutions (MoF and BOU) into dynamic and well-managed vehicles for development. This has been a result of strong political leadership (the President's hands-on approach in policy reform) and technocratic management (at senior levels).

The challenge for Uganda is to implement further structural changes in favour of the productive sectors to achieve sustainable development and reduce reliance on aid flows by creating an environment which facilitates the growth of the private sector to replace public sector dominance in economic production and the provision of essential services. The support of budget and sectoral support (instead of tied project aid) by the donors reflects their commitment to the government's change in focus. However, what will be required is an improvement in the institutional framework (rules and structures), and an upgrade of the effective management in the line ministries and supporting agencies (especially the URA and local government) to the same level as seen in the core economic ministries.

The 1995 Constitution enshrined inter alia popular participation and the right to association and led to a proliferation of non-governmental organisations from about 1,000 in the mid-90s to more than 3,000 in 2000. This partially reflects the availability of donor funding and the government's receptiveness to participation in policy formulation by the electorate. NGOs and civil society have excelled in the provision of advocacy and monitoring (economic policy and community development and political reconciliation) and service delivery (particularly in the key sectors of education, health, water supply and agricultural information). Both donors and the government have used NGOs to effectively channel funding.

While Uganda's use of the participatory process is widely appreciated in Uganda and by the donors who resort to it for their periodic evaluations, there is concern that the large numbers of NGOs and similar organisations makes it difficult to coordinate initiatives, planning and the equitable allocation of resources. The government would prefer that donors provide information on planned support for these organisations through the MoF's Aid Liaison Department. The donors have broadly embraced the need for co-ordination; as a general rule aid will in the future be given as budget support and in exceptional cases, channelled in line with the government's sector-wide programmes.

Nevertheless, despite being in receipt of increasing levels of aid since 1986 and recording growth rates of an average 6% in the 90s, the country remains one of the poorest in the world with a per capita GNP of US$291.

Progress has been recorded in developing the structure of the financial sector and commercial justice to enhance private sector development, though work is still required in instilling good corporate governance ethics, including improving the operational effectiveness of tax revenue collection. Incidents of corruption in most public and private institutions continue to be reported. In its 2001 Corruption Perceptions Index, Transparency International ranked Uganda third most corrupt country out of 91 across

67 Chen, D and Reinikka R. (1999), "Can Taxation be a Constraint in Low-Revenue Economy? – Evidence for Uganda".

the world[68]. The framework for constitutional reform is in place, but the controversy regarding multiparty democracy continues to dog the government. That said, Uganda has led other states in its utilisation of civil society consultation and participation in economic and political policy formulation. Compared to other low-income countries with large rural-based societies, Uganda has a highly politicised population.

Weak administration and management skills in the support government ministries, local government institutions and the Uganda Revenue Authority continue to be of concern. The line ministries and local governments are hampered by the lack of clear objectives, failure to identify or prioritise projects and poor financial management of available funds, all primarily a result of limited resources at these lower levels.

Inadequate trade polices which do not provide global reach together with a lack of the country's infrastructure, difficult access to export finance and corruption are major impediments to the promotion of trade in Uganda. In addition trade is very concentrated in few commodity products and therefore reliant on price fluctuations. Still, the diversification of exports, the prevention of external shocks and the enhancement of regional trade remain a challenge for the government.

4. INSTITUTIONAL INFRASTRUCTURE ASSESSMENT

OVERALL SCORECARD

		Quality[69]					
		1	**2**	**3**	**4**	**5**	**6**
Political System	Rules				X		
	Structure				X		
	Management[70]				X[71]		
	Combined Rating				**X**		
Legal Framework	Rules			X			
	Structure		X				
	Management		X				
	Combined Rating		**X**				
Financial System	Rules					X	
	Structure				X		
	Management				X		
	Combined Rating				**X**		
Corporate Governance	Rules	X					
	Structure	X					
	Management	X					
	Combined Rating	**X**					
Trade & Competition	Rules			X			
	Structure			X			
	Management				X		
	Combined Rating			**X**			
Overall Rating				**X 3.0**			

68 Uganda had a Corruption Perceptions Index (CPI) score of 1.9. The CPI score relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).
69 Rating scale 1 (low) to 6 (high)
1 Fundamentally unsound
2 Unsatisfactory
3 Inadequate
4 Satisfactory
5 Good
6 Consistently good
70 Based on detailed management scorecard (see net page)
71 The management of the core public economic institutions (MoF, BOU) is exemplary, but the overall rating is adversely affected by weaknesses in the absorptive capacity and management of line ministries and local governments, as well as the continuing controversy regarding multiparty democracy.

MANAGEMENT SCORECARD

		Quality					
		1	2	3	4	5	6
Political System	Objective Setting & Accountability						X
	Quality of Personnel				X		
	Effective Decision Making					X	
	Efficiency of Procedures					X	
	Costs / Waste				X		
	Corruption		X				
	Combined Score				**X**		
Legal Framework	Objective Setting & Accountability		X				
	Quality of Personnel		X				
	Effective Decision Making			X			
	Efficiency of Procedures		X				
	Costs / Waste		X				
	Corruption		X				
	Combined Score		**X**				
Financial System	Objective Setting & Accountability					X	
	Quality of Personnel				X		
	Effective Decision Making				X		
	Efficiency of Procedures					X	
	Costs / Waste					X	
	Corruption				X		
	Combined Score				**X**		
Corporate Governance	Objective Setting & Accountability			X			
	Quality of Personnel		X				
	Effective Decision Making		X				
	Efficiency of Procedures		X				
	Costs / Waste	X					
	Corruption	X					
	Combined Score		**X**				
Trade & Competition	Objective Setting & Accountability			X			
	Quality of Personnel			X			
	Effective Decision Making			X			
	Efficiency of Procedures			X			
	Costs / Waste		X				
	Corruption		X				
	Combined Score			**X**			

POLITICAL DEVELOPMENTS [72]

- Political instability and social unrest marked the immediate years following Uganda's independence in 1962. There were eight changes of government between 1962 and 1986, four of these achieved by military force. Most of the violence was ethnically directed by the Nilotic people of the North against the Bantu of the South.

- The federal constitution imposed by Britain facilitated some autonomy for the various districts and kingdoms (there are about 30 major tribal groups) and the first government was a North-South alliance. However, this was short-lived, as Mr. Obote, the prime minister from the North, with the support of the Northern army, alienated the Southern population. He seized power in 1966, declaring himself president by suspending the federal constitution. His presidency was essentially a military dictatorship.

- Idi Amin ousted him from power in military coup in 1971. Idi Amin oversaw the death of over 300,000 people, surrounding himself with ministers from his own Kakwa tribe. Amin was overthrown in 1979 by a force of Ugandan émigrés, backed by the Tanzanian army.

- A new government under Yusufu Lule was installed, but his term was short-lived. A military commission, under Paolo Mwanga, a staunch ally of Mr. Obote, assumed power. The newly formed Uganda National Liberation Army (UNLA) wanted Mr. Obote back in power.

- A general election in 1980 returned Mr. Obote and his party, Uganda People's Congress (UPC) to power. Although the election process was deemed satisfactory, there is little doubt in hindsight that the army used its power to get what it wanted. The Democratic Party formed the opposition, but the Uganda Patriotic Movement (UPM) refused to work with the UPC and Mr. Yoweri Museveni left with a small band of rebels that became the National Resistance Army (NRA).

- Mr. Obote's second term in power further alienated the Southern population and the NRA came to control a large part of the South. Mr. Obote used his army against those suspected of helping the NRA and mass bloodshed and loss of life ensued. Mr. Obote was finally undone by ethic rivalries within his own party.

- A Military Council replaced the government of Mr. Obote under the chairmanship of General Tito Okello. Attempts were made to involve Mr. Museveni in a national settlement, but he refused to work with any individual from the previous regime.

- In January 1986, the NRA marched on Kampala and seized power. The Military Council was dissolved and replaced by the National Resistance Council, comprising senior members of the NRA and the National Resistance movement (NRM) with Mr. Museveni as president.

- Museveni was formally elected to president in 1996, winning over 75% of the vote. The government and international donors quickly began to rebuild the Ugandan economy and an aggressive reform package that liberalized trade and introduced discipline to monetary and fiscal policy paid dividends in terms of sustained growth rates of over 6% during most of the 90s. Museveni was re-elected in 2001 for his final five-year term.

72 Background notes.

APPENDIX 2

IMF AND WORLD BANK SUPPORT (1980-1997) (US$ MILLION, CURRENT)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993/ 97
IMF	89	212	293	378	337	305	249	274	252	225	282	330	344	389
WB	47	61	92	123	213	322	413	584	629	710	969	1109	1209	1710
Total	136	273	385	501	550	627	662	858	881	935	1251	1439	1553	2099

Source: World Development Indicators 1999 CD-Rom version

APPENDIX 3

SECTORAL COMPOSITION OF PUBLIC EXPENDITURE (% OF TOTAL EXPENDITURE)

Sector Shares	1997/98	1998/99	1999/00
Education	26.0	26.9	26.2
Public administration	24.9	20.7	20.5
Security*	14.8	19.8	15.0
Roads & works	4.9	6.2	8.2
Interest payments due	7.6	7.0	7.7
Law & order	8.9	7.2	7.4
Health	6.6	6.7	6.4
Economic functions, social services & multisectoral	4.1	2.7	4.6
Agriculture	1.1	1.0	1.4
Water & sanitation	0.5	1.2	1.3
Accountability	0.5	0.6	0.6
All sectors	100.0	100.0	100.0

* Incl. Defence, ISO/ESO, pensions

Source: Uganda Poverty Status Report, 2001, Ministry of Finance, Planning & Economic Development

Notes: Data excludes externally finances development expenditure, arrears and promissory notes

LIST OF PEOPLE INTERVIEWED

IVORY COAST

Name	Position and Organisation
M. Narcisse Aka	Secrétaire général, Cour d'arbitrage de Côte d'Ivoire
M. Beudré	Directeur, BCEAO/Commission Bancaire
Mde. Alexandra Bensch	Conseiller économique, Délégation de la Commission européenne
Jean-Claude Chesnais	Agence française de développement
M. Cohan	Assistant technique, Projet Appui au Secteur Privé Ivoirien Ministère du Commerce
M. Siaka Coulibali	Conseiller de programme, UNDP
M. Yssouf Gbané	Directeur adjoint, Compagnie Bancaire de l'Atlantique, Côte d'Ivoire
M. Benjamin Hountoun	Conseiller de programme gouvernance, UNDP
Mde. Madelein Oka-Balima	Conseiller de programme, UNDP
M. Jules Pangni N'Guessan	Directeur de la métrologie, de la concurrence, du contrôle de la qualité et de la répression des fraudes, Ministère du commerce
Lamine Sylla	Fédération Nationale des Industries et Services de Côte d'Ivoire, Directeur général adjoint
M. Swartz	Service de Coopération et d'Action Culturelle en Côte d'Ivoire (France)
M. Michel Tahi	Directeur adjoint du budget et des finances, Ministère de l'économie et des finances
M. Michel Tizon	Chambre de commerce et d'industrie française en Côte d'Ivoire
M. Seydou Traore	Directeur général adjoint du budget et des finances, Ministère de l'économie et des finances
M. Bakary Traore	Juriste, OHADA

MALAYSIA

Name	Position and Organisation
Tan Sri (Dr) Ramon Navaratnam,	Director ASLI, Group Corporate Adviser, The Sunway Group, Asian Strategy & Leadership Institute
Mr. Nik Abdullah Shukri Nik Mustapha,	Head, Group Corporate Planning & Research Department, Bank Industri & Teknologi Malaysia Berhad
Mr. Zamros Dzulkafli	Assistant Manager, Group Corporate Planning & Research Department, Bank Industri & Teknologi Malaysia Berhad
Mr. Suhaimi Ali	Senior Executive, Strategic Planning Unit (information and documentation), Bank Negara Malaysia (the Central Bank)
Dr Victor Wee	Senior Director, Macroeconomics and Evaluation Section, Economic Planning Unit, Prime Minister´s Office [74]
Mr. Lee Cheng Suan	CEO, Federation of Malaysian Manufacturers;
Ms. Madeline Loh,	Manager Economics Division, Federation of Malaysian Manufacturers
Dr. Zulkurnain Haji Awang	Director/CEO, INTAN; National Institute of Public Administration
	Kuala Lumpur Stock Exchange; published information
Ms Tan Chek Yiang	Manager Research, Malaysian Industrial Development Finance Berhad
	Ministry of Finance; published information
Mr Joseph Doraisamy	Principal Assistant Director, Policy and Research together with colleagues from the policy team, Ministry of International Trade and Industry
Mr Wilson Wong	IT Policy and Strategy, together with colleagues, National Information Technology Council
	National Institute of Accountants; published information
	Securities Commission of Malaysia; published information
Professor Cassey Lee	Faculty of Applied Economics, University of Malaya; Department of Applied Economics;

Note: Institutions Consulted[73]

73 Information was obtained either in person or through web-sites and publications. Several meetings were also held with private sector business executives representing a range of businesses and views. International sources were also used, including the Asian Development Bank and World Bank. This report has also benefited from the interesting and helpful insights contained in "Malaysia's Economic Sustainability" by Dr Ramon Navaratnam (Pelanduk Press; published 2002).

74 The report draws widely on the data and information kindly provided by the EPU.

MOROCCO

Name	Position and Organisation
Mr Said Aqri	Head of Studies Division, Foreign Investment Department Ministry of Finance
Mr Amari	Advisor, Ministry of General Affairs
Mr Nourreddine Ayouch	President, Fondation Zakoura
Mr Bouazza	Director of Central Directorate, Banque Al-Maghrib
Mr Chami	President, General Confederation of Moroccan Businesses
Mr Abdesalam Chebli	Head of Division Bilateral and Regional Financing Budget Directorate, Ministry of Finance
Mr Rémi Genevey	Director, Agence Française de Développement
Mr Olivier Godron	Country Office Manager, The World Bank
Mr Emilio de la Guardia	General Director, Morocco and North Africa, COFIDES
Mr Denis Healey MVO	Consul-General, British Consulate General
Mr Mohammed Kabbaj	Head of Division for Multilateral Financing and Budget Directorate, Ministry of Finance
Mr Abdelouhab Laraki	Associate, Maroc Defi Consultants
Mr Mansouri	Secretary General, Ministry of General Affairs
Mr Alain Séve	Head of Division Maghreb Country Division, European Investment Bank
Prof. Mohamed Tozi	Faculté des Sciences-Politiques, Sociales et Juridiques, University Hassan II

PAKISTAN

Name	Position and Organisation
Mueen Afzal	Secretary General, Ministry of Finance
Tanwir Ali Agha	Minister, Economic Affairs, Embassy of Pakistan in the US
Jamil Ahmed	Ex Chief Secretary, Baluchistan
Shahnaz Wazir Ali	Executive Director, Pakistan Centre
Sadruddin Ashwani	Businessman
Akber Aziz	Shell Pakistan
Daniyal Aziz	National Reconstruction Bureau
Mehnaz Aziz	Advisor, Ministry of Education
Farhan Bohkari	Financial Times correspondent
Fateh Chaudhry	Advisor, Mahbub ul Haq Centre
Shahid Chaudhry	Deputy Chairman, Planning Commission
Mushahid Husain	Former Minister of Information
Peter Portier	Delegation of the European Union
Shoaib Sultan Khan	Chairman, National Rural Support Programme
Roedad Khan	Former advisor to Presidents of Pakistan
Jehed ur Rahman	Head, SAP Multi Donor Support Un
Tahseen Sayed	Education Specialist, World Bank
Mateen Thobani,	Advisor, Privatisation Commission
John Wall	Director for Pakistan, World Bank
Nasim Zehra	Columnist

PERU

Name	Position and Organisation
Mr. Enrique Arroyo	General Manager, Bankers' Association
Mr. Alejandro Chilinos	Director, Instituto de Libertad y Democrácia
Mr. Carlos Guiesecke	Director of the Office of Investments, Ministry of Economy and Finance
Mr. Claudio Higa	COFIDE
Mr. Victor Mora	IADB
Mr. Roberto Olivares	Director, Superintendencia de Banca y Seguros
Ms. Isabel Quevedo	Director, Banco Interamericano de Finanzas
Ms. Keta Ruíz	Chief Officer, World Bank
Mr. Mario Ventura	General Manager, America Leasing
Mr. Fernando Villarán	Employment Minister

POLAND

Name	Position and Organisation
Andrzej Brzoska	Director Invest Bank
Mr. Pawel Durjasz	Director, National Bank of Poland
Marek Fila	Director BPH Bank
Mr. Mateusz Golab	Board Advisor, Raffeisen Bank Polska
Agnieszka Gorgunowska	Marketing Manager DGA Poland
Ewa Kakiet-Springer	President, Citizens Democracy Corps Foundation Poland
Mr. Piotr Kalaman	General Manager, Caresbac Polska
Stefan Kawalec	Chief Advisor Bank Handlowy
Tomasz Kilianski	Polish Enterprise for SME Development
Ms. Malgorzata Puczylowska	British Know How Fund in Warsaw
Mr. Edmund Saunders	President, Polish Institute of Banking
Kurt Sebastian	Vice President Datatronic Poland (SME)
Andrzej Schafernaker	Business Consultant
Jerzy Suchnicki	President Raiffeisen Investment
Ms. Lidia Wilk	Director Strategic Planning, PKO BP
Ms. Joanna Zebrowska	Polish Agency for Regional Development
Darius Zielinski	Director Kredit Bank

TRINIDAD AND TOBAGO

Name	Position and Organisation
Ms Sharri Byron	Research Analyst, Ministry of Finance
Mr Wayne Dass	Senior Corporate Manager, Development Finance Ltd
Mr Prakash Dhanrajh	Vice-President, MicroFin
Hon. Conrad Enill	Minister, Ministry of Finance
Mr Cecil Camacho	Senior Partner, De Nobis , Innis & Co
Mr Stuart Dalgleish	President, Trinidad and Tobago Manufacturers Association
Ms Lisa M. Chamely	Executive Director, Trinidad and Tobago Manufacturers Association
Mrs Amoy Chang Fong	Deputy Governor, Central Bank
Mr Jerry Hospedales	Co-ordinator, Divestment Secretariat, Ministry of Finance
Mr Jo Howard	Director, Socio-Economic Planning Division, Ministry of Planning and Development
Dr Andrew Jacque	Programme Co-ordinator, Ministry of Planning and Development
Mr Rabindra Jaggernauth	Partner, Ernst & Young
Mr Eric James	Director, Project Planning Division, Ministry of Planning and Development
Ms Donna-Mae Knights	Co-ordinator Development Projects, Office of the Prime Minister
Mr William Lucie-Smith	Managing Partner, PWC Management Ltd.
Mr Terry Martins	CEO, Royal Bank
Mr Anthony Maughn	Senior Sector Specialist, CDB
Mr Michael O'Donnell	Senior Sector Specialist, IADB
Mr Gerard Pemberton	Managing Director, Development Finance Ltd
Mr Jewan Ramcharitar	Managing Partner, PWC Management Consultants
Ms Debbie Solomon	Manager, FundAid
Mrs Jocelyn Thompson	Auditor General, Auditor General's Office
Mr Mark Wenner	Financial Specialist, Rural Development Unit, IADB
Mr Leon Liu Yat	Manager, Investment Facilitation, TIDCO – Tourism and Industrial Development Company of Trinidad and Tobago
Mr Edgar Zephyrin	Programme Director, Community Development Fund
Ms Jean McCardle	East Caribbean Office. CIDA
Ms Sarah Barlow	East Caribbean Office, DFID
Ms Lena Ashuvud	Country Officer, East Caribbean, EIB
Mrs Sari Suomalainen	Head of Delegation, EC Delegation
Mr Paul Rainier	Counsellor, EC Delegation
Sister Rosario	Director, HOPE

UGANDA

Name	Position and Organisation
Estelle Aryada	Programme Office, Private Sector Foundation
Michael Atingi-Ego	Acting Director, Bank of Uganda, Research Department
Bob Blake	Country Representative, World Bank
Fiona Davis	Senior Economist, MoF, Macroeconomics Department
Kailash Giri	Treasury Manager, Stanbic Bank Uganda
Lene Hansen	Programme Manager, European Union, SUFFICE Project
Alain Joaris	Economic Counsellor, European Union, Delegation of EC
Louis Kasekende	Deputy Governor, Bank of Uganda
Chris M. Kassami	Permanent Secretary, MoF / Treasury
Boney Katatumba	Chairman, Chamber of Commerce
Haruna Kyamanywa	Governance Adviser, UNDP
Kenneth Magambe	Assistant Commissioner, MoF, Econ. Dev. Policy & Research Dept.
Kevin Makokha	Country Representative, Veco-Uganda
Miria Matembe	Minister, Ministry of Ethic & Integrity
Keith Muhakanizi	Director, MoF, Economic Affairs
Charles Ocici	Executive Director, Enterprise Uganda
Patrick Ocailap	Commissioner, MoF, AID Liaison Department
Peter Olivier	Exec. Director/Acting MD at UCB, Stanbic/Uganda Commercial Bank
Michael Opagi	Director, MoF, Privatisation Unit
Emmanuel Tumusiime-Mutebile	Governor, Bank of Uganda
Robert Waweru	Senior Consultant, Delloitte & Touche
Tim Wiliams	Governance Adviser, DFID
Ulrike Wilson	Country Representative, East Africa Association

BIBLIOGRAPHY

General

CIA, CIA World Factbook

IMF, (2001), International Financial Statistics, 2001

IMF World Economic Outlook Database

Kaufmann, D., A. Kraay and P. Zoido-Lobatón, (1999), Aggregating Governance Indicators. World Bank Policy Research Department Working Paper, No. 2195.

Kaufmann, D., A. Kraay and P. Zoido-Lobatón, (2002), Governance Matters II Updated Indicators for 2000/01

OECD-DAC, online database

U.S. Department of State, (2001, Commercial Guides

World Bank, (2001), World Bank Development Indicators

World Bank, (September 2001), countries at a Glance

World Bank Policy Research Department (1999), Corporate Governance and Stock Market Performance in CEE, Anete Pajuste, April 2002Aggregating Governance Indicators,

World Economic Outlook Database, (2001)

WTO,WTO Trade policy reviews

Ivory Coast

BAD, (2002), Appui à la gouvernance et au renforcement des capacités

BCEAO, Rapport annuel 2000

BCEAO/ILO, (1999) Banque de données sur les systèmes financiers décentralisés

Devarajan, S., D.R. Dollar and T. Holmgren, eds., (2001), Aid and Reform in Africa - Lessons from 10 case studies. World Bank. Washington DC.

Gouvernement de Côte d'Ivoire, (2002), Interim Poverty Reduction Strategy Paper,

IDC, (1998), Evaluation de l'aide de l'Union Européenne aux pays ACP, Etude de Pays n°3: Côte d'Ivoire

IFC, Annual Report, 1997.

IFC/FIAS, (2002), Sénégal: Parcours de l'investisseur, une réévaluation

IMF, (2001), Staff Report for Article IV Consultation and Staff-monitored programme

IMF,(2000), Côte d'Ivoire: Selected Issues and Statistical Appendix

International Monetary Fund Staff Country Report No. 00/107, (2000), Côte d'Ivoire: Selected Issues and Statistical Appendix. Washington, D.C.

International Monetary Fund Staff Country Report No. 98/46, (1998), Côte d'Ivoire: Selected Issues and Statistical Appendix. Washington, D.C.,

International Monetary Fund, (2001), Article IV Document IMF Website. Washington, D.C.,

International Monetary Fund, (1999), Public Information Notice: IMF Concludes Article IV Consultation with Côte d'Ivoire. Washington, D.C.,

International Monetary Fund, (2002), Côte d'Ivoire- International Financial Statistics. Washington, D.C.

International Monetary Fund, (1995), Press Release: IMF Approves Second Annual Loan for Côte d'Ivoire Under the ESAF. Washington, D.C.,

Jean-Paul Azam/ OECD, (1994), La faisabilité politique de l'ajustement en Côte d'Ivoire

Ministère de l'industrie et de la Promotion du secteur privé/UNIDO, (2002), Programme cadre pour le développement du secteur privé, Environnement/Forces et faiblesses, OED, (1999), Côte d'Ivoire: Revue de l'aide de la Banque mondiale au Pays

Rudolf V. Van Puymbroeck ed./World Bank, (2000), Comprehensive legal and judicial development

The Economist Intelligence Unit Limited, (2001), Côte d'Ivoire-.EIU Country Profile. London

The Economist Intelligence Unit Limited, (Feb. 2002), Côte d'Ivoire-.EIU Country Report. London

UEMOA, Commission Bancaire, Rapport annuel, 2000

UN, (2001), Rapport de la Commission d'enquête internationale pour la Côte d'Ivoire

UNDP, (1999), ONG actives et Structures de la Société Civile,

US Department of State, (1995), Côte d'Ivoire human rights practices

World Bank Project Information Document (Sep. 1999), Côte d'Ivoire- Financial Sector. Washington, D.C.

World Bank, (1998), Assessing Aid: what works, what doesn't and why

Malaysia

Asian Development Bank, (20022), Economic Trends and Prospects. Also Country Performance Assessment 2002

Bank Industri Malaysia Berhad, Assessment of Development Impact 1979-1998

Bank Negara Malaysia, (1999), The Central Bank and the Financial System in Malaysia

Bank Negara Malaysia, (2001), The Master Plan; building a secure future for the financial sector

Bank Negara Malaysia, Annual Report 2001 and 1991-2000

Business Times; Various articles

Economic Planning Unit, Dr Victor Wee, Senior Director, (2002), Malaysia's Economic Development Process and Achievements,

Federation of Malaysian Manufacturers; Annual Report and other Documents

Institute of Public Administration, (2002), INTAN Training Projects and Technical Co-operation Programme

Malaysia Industrial Development Finance Berhad, Annual report 2001

National Information Technology Council, The Malaysian IT interface

National Information Technology Council, Access, Empowerment and Governance in the Information Age

Dr. Ramon Navaratnam, (2002), Malaysia's Economic Sustainability

New Straits Times; Various articles

Securities Commission, Capital Markets Master Plan

In addition a wide range of information available on the Internet was reviewed.

Morocco

African Development Bank Document (September 2000), Country Strategy Paper 2000-2002. Abidjan, Ivory Coast.

Agence Française de Développement (2000). Project Evaluation Report 2000. AFD, Paris, France.

Barth, J.R., G. Caprio, Jr., and R. Levine, (2001), The Regulation and Supervision of Banks Around the World: a New Database. World Bank: Washington DC.

Fondation Zakoura. (2001) Annual Report 2001. Casablanca, Morocco

International Monetary Fund Staff Country Report No. 97/6, (Feb. 1997), Morocco: Selected Issues. Washington, D.C

International Monetary Fund, (Jun. 1999), Public Information Notice: IMF Concludes Article IV Consultation with Morocco. Washington, D.C

International Monetary Fund, (Sep. 2000), Public Information Notice: IMF Concludes Article IV Consultation with Morocco. Washington, D.C

International Monetary Fund, (May 2001), Public Information Notice: World Bank Board Discusses Morocco Country Assistance Strategy. Washington, D.C

International Monetary Fund, (Aug. 2001), Public Information Notice: IMF Concludes 2001 Article IV Consultation with Morocco. Washington, D.C

International Monetary Fund, (Nov. 2001), Morocco: 2001 Article IV Consultation- Staff Report: Public Information Notice: and Statement by the Executive Director for Morocco. Country Report. Washington, D.C

The Economist Intelligence Unit Limited, (Nov. 2001), Morocco at a Glance: 2002/03. EIU Country Report. London

The Economist Intelligence Unit Limited, (Jan. 2002), Morocco at a Glance: 2002/03. EIU Country Report. London

The Economist Intelligence Unit Limited, (2002), Morocco. EIU Country Report. London

The Ministry of Industry, Commerce, Energy and Mines/ The World Bank (February 2002) , Moroccan Manufacturing Sector at the Turn of the Century –Results of the Firm Analysis and Competitiveness Survey. Rabat/Washington

World Bank Document. (May 2001). Kingdom of Morocco. Country Assistance Strategy 2001-2004. Washington, D.C.

World Bank Document, (Sep. 2000), Kingdom of Morocco. Financial Sector Strategy Note. Washington, D.C.

World Bank Document, (Mar. 2001), Kingdom of Morocco. Poverty Updated. Washington, D.C.

World Bank- Operations Evaluation Department, (May 2001), Morocco: Country Assistance Evaluation. Washington, D.C.

Pakistan

Asian Development Bank, (July 2001), Country Strategy and Program Update

Asian Development Bank, Appraisal Report on proposed loans and grant for the Access to Justice Program

Asian Development Bank, Appraisal Report on proposed loans and grant for the Access to Justice Program

Emma Duncan, (1989), Breaking the Curfew - A Political Journey Though Pakistan

Government of Pakistan, Interim Poverty Reduction Strategy paper – I PRSP 2010 Vision Statement

Government of Pakistan, Local Government Plan (NRB)

Government of Pakistan, 1973 Constitution

Parvez Hasan, (1998), Pakistan at a Cross roads

Ishrat Husain, (2000), Pakistan - the Economy of an Elitist State

IMF, (April 2002), First review under the 3-year Arrangement under the PRGF; staff report and statement; Brief on Board discussion

IMF-World Bank, (November 2001), Joint Staff assessment of the I-PRSP

Roedad Khan, (1997), Pakistan A dream gone sour

NRSP, Annual Report 2000

State Bank of Pakistan, Annual report 2000

US Library of Congress, (February 2002), Issue Brief for Congress Pakistan-US Relations

World Bank, (November 2000), Pakistan – Reforming Provincial Finances in the Context of Devolution

World Bank, I(January 2002), improving Human Development Outcomes in Pakistan

World Bank, (1998), Pakistan – A Framework for Civil Service Reform

World Bank, (July 2001), Pakistan - CAS Progress Report

World Bank, (October 2001), Appraisal report for a Banking restructuring and privatisation project

World Bank, (April 2002), Pakistan - Development Policy Review

Peru

Instituto APOYO, (March 2002), The impact of the Judiciary in business decision making in Peru

Asbanc, (September 2001), Boletín Financiero y Económico

Development Alternatives Inc., (2000), The Transformation of Acción Comunitaria del Perú to Mibanco

Economic Commission for Latin America and the Caribbean (Cepal), (2001), Country Report on Peru

Gilberto Llanto, (September 1999), Credit Policy and Microfinance Institutions

IMF, (2001), Balance de la Situación Económica Actual, Ministerio de Economía y Finanzas, Perú

Cesar Landa, (2001) The Scales of Justice in Peru, Judicial Reform and Fundamental Rights

Constitution of Peru (1993)

Lawyers Committee for Human Rights, (April 2000), Building on Quicksand, The collapse of the World Bank's Judicial Reform Project in Peru

Management Systems International, (July 2000), Democracy and Governance in Peru: An assessment

Ministerio de Economía y Finanzas, Perú, Planeamiento Estratégico en el Sector Público

PEPCMAC, (July 2001), La evolución de la Cajas Municipales

Fernando Villarán, (May 1998), Visión Estratégica para el Desarrollo de la Pequeña Empresa.

World Bank (October 1997), World Bank Project Information Document on Judicial Reform

Poland

EBRD (March 2002), Strategy for Poland Report

EBRD, Poland Investment Profile
The Economist Intelligence Unit (EIU), (2001), Poland Report

EU, (November 2001), EU Regular Report on Poland's Progress towards Accession

Freedom House, (2002), Freedom House Report on Poland

Ministry of Economy Poland, Foreign Trade Analysis

World Bank (April 2002), Draft Country Strategy Report

Trinidad and Tobago

Barth, J.R., G. Caprio, Jr., and R. Levine, (2001), The Regulation and Supervision of Banks Around the World: a New Database. World Bank: Washington DC.

Central Bank of Trinidad and Tobago, (Aug. 1995), A Consolidation of the Financial Institutions Act 1993, Subsidiary Legislation and Guidelines. Trinidad & Tobago.

Central Bank of Trinidad and Tobago, (Nov. 2001), Economic Bulletin- Volume III Number 3. Trinidad & Tobago.

Development Finance Limited-DFL, (2001), Annual Report 2001. Trinidad & Tobago.

Inter-American Development Bank, (Aug. 2001), Economic Situation and Prospects. Trinidad and Tobago.-Badrul Haque. Washington, D.C

International Monetary Fund Staff Country Report No. 99/67, (Jul. 1999), Trinidad and Tobago: Selected Issues and Statistical Appendix. Washington, D.C

International Monetary Fund, (Mar. 2000), Memorandum of Economic and Finantial Policies of The Government of Trinidad and Tobago for 1999/00. Washington, D.C

International Monetary Fund, (Jul. 2001), Public Information Notice: IMF Concludes Article IV Consultation with Trinidad and Tobago. Washington, D.C

International Monetary Fund, (Mar. 2002), Trinidad and Tobago- International Financial Statistics. Washington, D.C

Project Planning and Reconstruction Unit.- Ministry of Finance, (Sep. 2001), Republic of Trinidad and Tobago.- Public Sector Investment Programme 2002. Trinidad & Tobago.

The Economist Intelligence Unit Limited, (2001), Trinidad and Tobago- Political Background. EIU Country Profile. London

The Economist Intelligence Unit Limited, (Jan. 2002), Trinidad and Tobago at a Glance: 2002/03. EIU Country Risk Service and Country Profile. London

Trinidad and Tobago Government, (2002), Key Economic Indicators, Standard & Poor's -Trinidad and Tobago Ratings and Trinidad and Tobago Economic Policy Framework. Trinidad & Tobago.

World Bank Document (Mar. 1999), Memorandum of the President of the International Bank for Reconstruction and Development to the Executive Directors on a Country Assistance Strategy of the World Bank Group for the Republic of Trinidad and Tobago. Washington, D.C.

World Bank Public Information Notice (Apr. 1999), Trinidad and Tobago Country Assistance Strategy. Washington, D.C.

World Bank Project Information Document (Jun. 1999), Trinidad and Tobago- Judicial Reform Project. Washington, D.C.

World Bank Website, (Feb. 2002), Country Assistance Strategy Public Information Notice.- World Bank Board Discusses Country Assistance Strategy for Trinidad and Tobago. Washington, D.C.

Uganda

Bank of Uganda, Research Department, (March 2002), Summary Finding of Private Capital Flows Survey 2001, Draft copy for information only.

Bigsten, A and Kayizzi-Mugerwa, S., (1999), "Is Uganda an Emerging Economy?", OECD.

Department for International Development, UK Government, (November 2000), Annual Plan and Performance Review: Uganda

Devarajan, S., D.R. Dollar and T. Holmgren, eds., (2001), Aid and Reform in Africa - Lessons from 10 case studies. World Bank: Washington DC.

International Monetary Fund Survey, (Nov. 2002), Uganda: Real GDP Growth and Underlying Trends. Washington, DC.

International Monetary Fund, (Jun. 1998), Press Information Notice: IMF Concludes Article IV Consultation with Uganda. Washington, D.C.

International Monetary Fund, (Mar. 2002), Uganda- International Financial Statistics. Washington, DC.

Ministry of Finance Planning and Economic Development, (2001), Background to the Budget 2001-2002, Republic of Uganda.

Ministry of Finance, Planning and Economic Development, (August 2000), Medium-Term Competitive Strategy for the Private Sector (2000-2005)

Ministry of Finance, Planning and Economic Development, (December 2001), Poverty Eradication Action Plan, Volume 3

Ministry of Finance, Planning and Economic Development, (November 2001), Budget Performance Report, 2001/01

OECD Development Assistance Committee, (1997), Evaluation of Programs Promoting Participatory Development and Good Governance

The Economist Intelligence Unit Limited, (2002), Uganda-The Economy. EIU Country Profile. London

The Economist Intelligence Unit Limited, (2001), Uganda-Political Background. EIU Country Profile. London

The Economist Intelligence Unit Limited, (Mar. 2002), Uganda at a Glance: 2002/03. EIU Country Profile. London

World Bank Project Information Document (Jul.2001), Uganda- Financial Sector Strengthening. Washington, DC.

World Bank, Operations Evaluations Department, (April 2001), Uganda Country Assistance Evaluation, Uganda Stakeholder Voices: Perceptions of the World Bank's Country Assistance Strategy, Report No. 22120. Washington, DC.

World Bank, Operations Evaluations Department, (Fall 2001), Uganda: Policy, Participation, People, No. 214. Washington DC.

World Bank, World Development Indicators CD-ROM, (2001), Uganda Social Indicators. Washington, DC.