

**REPORT AND RECOMMENDATION  
OF THE INSPECTION PANEL**

**Request for Inspection**

**BANGLADESH JUTE SECTOR ADJUSTMENT CREDIT  
(Cr. 2567-BD)**

**March 14, 1997**

## ABBREVIATIONS

<b>BJMA:</b>	Bangladesh Jute Mills Association (Private Mills)
<b>BJMC:</b>	Bangladesh Jute Mills Corporation (Public Mills)
<b>IDA:</b>	International Development Association
<b>JSAC:</b>	Jute Sector Adjustment Credit
<b>MOP:</b>	Report and Recommendation of the President
<b>OD:</b>	Operational Directive
<b>SDR:</b>	Special Drawing Rights

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*Box 1: Scope of Panel Mandate*

*Attachment 1. Receipt of Request*

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*Annex 1. Request for Inspection*

*Annex 2. Management Response*

## REPORT AND RECOMMENDATION OF THE INSPECTION PANEL

### Request for Inspection BANGLADESH JUTE SECTOR ADJUSTMENT CREDIT (Cr. 2567-BD)

Below is (A) Introduction, (B) Eligibility of the Request (C) The JSAC, (D) Discussion, and (E) Recommendation of the Inspection Panel ("Panel") on whether or not there should be an investigation ("Recommendation") into allegations made in the above-referenced Request for Inspection ("Request"). Annex 1 contains the Request. Management Response to the Request ("Response") is provided in Annex 2.

#### A. Introduction

1. On February 17, 1994, the Board of Executive Directors ("Board") of the International Development Association ("IDA") approved a SDR 175 million (US\$247 million equivalent) Jute Sector Adjustment Credit (Cr. 2567-BD) ("JSAC") to support the Government of Bangladesh ("GOB") in carrying out its reform program in the jute sector. It was anticipated that at the completion of the JSAC most of the jute sector would be in private hands.

2. The JSAC was designed to be disbursed in four tranches. Release of each tranche was conditional on the completion by GOB of various actions in support of its reform program. The first tranche of SDR 35 million (US\$51,991,725 equivalent) was released on April 5, 1994. It was anticipated that actions required for release of the second tranche of SDR 50 million and a floating tranche of SDR 40 million would be completed by March 1995 and for the third tranche of SDR 50 million, September 1996. No further disbursements have been made since the conditions for release of the subsequent tranches have never been met. The closing date of the Credit was originally December 31, 1996. At that time,

Management notified the Executive Directors of a six month extension of the closing date.

#### *The Request for Inspection*

3. The Request was filed in August 1996 by a group of Bangladesh citizens who are intended beneficiaries of the project. (the "Requesters"). The Request was resubmitted in November 1996. (See Attachment 1). The Requesters claim, in substance, that they and the jute private sector have been harmed rather than helped through some flaws in the design of the reform program and then by the increasingly adverse effects of the 3-year delay in implementation of the JSAC: as a result, the private sector is now worse off than before the JSAC.

4. Harm claimed includes closure of private jute manufacturing mills, loss of jobs for thousands of private mill employees, and loss to the nation's economy.

5. The Requesters claim that the harm has occurred as a result of acts and omissions by IDA Management ("Management") which violate IDA's policies and procedures. The Request does not identify relevant policies and

procedures, but the Panel observed in its Notice of Registration that the Allegations seem to relate to Operational Directives ("ODs"):

- 8.60 Adjustment Lending Policy
- 13.05 Project Supervision
- 13.40 Suspension of Disbursements

6. The Requesters also claim that the private sector was not adequately consulted during the design and implementation of the JSAC, particularly in the formal decision making process.

7. On December 26, 1996, the Panel received the Management Response ("Response") to the Request.

#### ***Management Response***

8. The Response asserts that:

- All relevant policies and procedures were and are being followed in the design and implementation of the JSAC.
- The actions and omissions of which the Requesters complain in relation to implementation are the responsibility of the GOB and do not involve any relevant actions or omissions on the part of IDA.
- Since acts and omissions in relation to implementation of adjustment credits—in contrast to investment credits—are the sole responsibility of the borrower, the Request is not within the Panel's mandate.

Nevertheless, Management deals with the substance of the Request and "makes clear the forceful and continuous efforts by Management to persuade the Government to implement promptly and effectively its Jute Sector Reform Program."

#### **B. Eligibility of the Request**

9. Pursuant to para. 19 of the Resolution it is the responsibility of the Panel to "determine whether the request meets the eligibility criteria set out in paragraphs 12 to 14" after it has received the Response. The Panel is satisfied that the Request meets the relevant criteria and that those signing the Request represent a sector that feels negatively affected by the design and implementation of the JSAC.

#### **Preliminary Evidence of Material Harm**

10. The Requesters allege both past and potential material harm if the JSAC remains in place with no improvement in performance and without restructuring. They claim the JSAC has caused:

- A decline in operating loomage in the private sector mills.
- A fall in actual production and exports.
- A fall in the market value of private sector mills.
- Temporary closure or reduction in capacity of 11 private mills.

11. The Requesters allege that the JSAC is responsible for the reduction of private sector capacity. Operating loomage for the private sector has dropped from 5955 looms in FY 1992-1993 to 3969 looms in December 1996. The Panel has examined closely two case studies of declining production and net income provided by the Requesters as documentation of the damaging process.

12. Without significant changes in the direction and performance of the program, the Requesters foresee major additional damage:

- Permanent closure of private sector mills, with related loss of security, income, and dislocation of careers;
- Job loss for thousands of employees;
- Loss to Bangladesh's economy and social welfare.

13. Management appears to agree with many of the Requesters' assertions. In its Mid-Term review of 18 September 1996, "the mission concluded that the cost of not implementing the program had been very high...It also found that since subsidies for public jute mills were high and provided for a longer period of time than for private mills, these were able to operate at full capacity, while private mills performed less well due to liquidity problems, since subsidies were not only lower for the latter but were also provided with delays. A *substantial* increase in wages for public sector mills, compensated by Government subsidies aggravated this situation and created labor unrest in private mills." [Emphasis added]

14. Management itself laid out the argument for what has happened: "BJMA's capacity utilization is understandably low because of the following reasons: (a) GOB is not financing losses; (b) MOF has de-linked itself to give any guarantee to the banks on the financial transactions that the mills will have with the banks -- bank-client relationship has been established since July, 1992; (c) if the mills remain open, they have to service the outstanding debt; and most importantly, (e) jute goods manufacturing is not profitable unless there is a significant increase in productivity. As the GOB is no more financing losses, the costs of uneconomically producing jute goods have to be borne by the owners, which, obviously, they do not want." The Requesters made much the same point.

15. Panel consultations with the Requesters confirmed Management's observations, and indicated that the cost has not only been "very high," but also pervasive enough in the private sector to cause long-term damage to the prospects for the industry. The Panel wants to point out, in addition, that consultations in Bangladesh revealed that all parts of the industry have been damaged by the postponement of reforms during the last three years. The public sector mills, facing an uncertain future, have had no access to investment capital. The workers in the jute mills have uncertain employment prospects in both public and private mills. And GOB finances have faced an ever increasing draw on the public treasury to finance the losses of public mills.

#### Cause of Harm

16. The fact that performance of the Requesters' mills has deteriorated since the Executive Directors approved the JSAC is not in dispute. However responsibility for harm is. Management does not deny responsibility for flaws that have emerged in the design phase but does disclaim responsibility for acts or omissions in the implementation phase.

#### Responsibility for Implementation of the JSAC

17. The Requesters and Management agree that harm has occurred as a result of failure to *implement* the JSAC but they have different views as to who is responsible. This is important, since the Panel is not authorized to deal with Requests "with respect to actions which are the responsibility of other parties, such as the borrower ...and which do not involve any action or omission on the part of the Bank." (Resolution ¶ 14(a)).

**BOX 1. Scope of Panel Mandate.** Once more Management alleges that a Request should be dismissed on formal grounds. The Panel notes with concern Management's allegation that "complaints in respect of delays in implementation are outside the jurisdiction of the Inspection Panel, which is not authorized to deal with complaints with respect to actions which are the responsibility of other parties, not IDA".

Since all projects and programs financed by the Bank/IDA are carried out by the borrower or executing entity and never by the Bank/IDA itself, if Management's allegation is to be accepted, then the Panel would lack jurisdiction in all cases where delays in the execution of a project or program has caused material and adverse effects to third parties.

The intent of the Resolution, and all precedents relating to its application by the Board of Executive Directors to date, seem to indicate that Management cannot disclaim responsibility for adverse effects of Bank/IDA-financed projects simply because it is not the executor of the activities included therein.

There are a number of specific policies and procedures regulating the design, appraisal, and execution of projects that must be followed by Management, and, if failure to do so results in harm to third parties, they can ask the Panel to recommend to the Board of Executive Directors an investigation of the matter.

Although the legal structure of an adjustment operation is different from that of an investment operation, there is no basis to allege that the Panel would not have jurisdiction over the former since a) such jurisdiction has been expressly recognized by the Board of Executive Directors, Senior Management, and the Panel<sup>1</sup>;

<sup>1</sup> see Memorandum of Mr. T. T. Thahane to IDA's Executive Directors and Alternates dated June 16, 1995, which expressly acknowledges this fact and attaches Memoranda from the Senior Vice President and General Counsel and the Panel's Chairman, that refer to a meeting between Senior Management and

and b) there are substantial remedies available to Management in case of failure by the borrower to comply with the conditions related to the release of one or more tranches. With respect to the latter, the Panel requested a legal opinion from the Senior Vice President and General Counsel on what remedies--aside from withholding the release of outstanding tranches--are available to IDA under sector adjustment credits in certain situations.<sup>2</sup> The opinion makes it clear that IDA has legal remedies beyond the mere withholding of tranche disbursement in circumstances such as those of the JSAC discussed below. However, it also points out that any responsibility for exercise of these remedies--as in investment operations--lies in Management and is a matter of judgment that must take into account all the circumstances of each case.

Taken together, the Response views on implementation and remedies appear to argue that IDA does not have responsibility for the outcome of an adjustment operation. In that case, this Request would appear to fall outside the mandate of the Panel. The notion that IDA is not responsible for application of its policies in the implementation of adjustment credits (in contrast to investment credits), and therefore is not subject to the jurisdiction of the Panel in effect contradicts the General Counsel's opinion referred to above. In addition, such a view could give rise to doubts on the rationale for IDA financing of adjustment operations.

18. For all the reasons outlined above, the Panel concludes that Requests relating to implementation of Sector Adjustment Loans and in particular, the JSAC, are within its mandate.

the Panel where the Panel's jurisdiction over SALs and SECALs was reviewed and agreed upon (Attachment 2)

<sup>2</sup> see Memorandum of the Acting Vice President and General Counsel to the Chairman of the Inspection Panel dated January 29, 1997, especially paragraph 3(a) (Attachment 3).

### **Panel Process**

19. The Panel's preliminary review of the Request and Response takes into account subsequent written and verbal information provided by the Requesters, Management and staff and consultations with the GOB in Dhaka and with the Executive Director representing Bangladesh in Washington.

20. The recent clarification of the Resolution allows the Panel to extend the 21-day period before submitting its recommendation as to the need, if any, for an investigation.<sup>4</sup> Since the Panel required more information from the Requesters and Management this period was extended until February 17, 1997 and the Executive Directors so informed<sup>5</sup>. On February 11, 1997, the Panel was satisfied that it had received sufficient additional information and then requested an extension of time until March 14, 1997 to consult with the borrower and Executive Director representing Bangladesh and prepare its recommendation in light of those consultations and the new information.<sup>6</sup>

### **Subsequent Information from the Requesters**

21. The Panel interviewed a representative of the Requesters and subsequently received further information and case studies.<sup>7</sup> The Chairman further discussed with the Requesters, as a group,

the matters raised in their documents during his time in Dhaka.

### **Subsequent Information from the Management**

22. A number of meetings were held with Management and staff involved in preparation and implementation of the program. The Panel requested and received a number of useful documents.<sup>8</sup> The Panel thanks the staff for their cooperation.

### **Consultations with GOB**

23. Pursuant to para. 21 of the Resolution, the Chairman of the Panel—in his capacity as lead Inspector for this Request—spent February 24-28, 1997 in Dhaka meeting with current and former GOB officials.<sup>9</sup> These consultations were most constructive and enabled the Panel to get a first hand view of GOB's approach to the problems with the JSAC. The Panel wishes to extend its thanks to the GOB for

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<sup>3</sup> In Memorandum from the Vice President and Secretary of IDA to the Executive Directors, June 16, 1995.

<sup>4</sup> INSP/SecM96-15, December 10, 1996.

<sup>5</sup> INSP/SecM97-3, January 23, 1997.

<sup>6</sup> INSP/R97-2, February 13, 1997. Agreed to by the Executive Directors on a no objection basis.

<sup>7</sup> Kh. Ralsuddin Ahmed to the Chairman of the Panel, dated January 30, 1997. Available from the Panel's office.

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<sup>8</sup> Memoranda dated: December 5, 1996 providing *Quarterly Reports on Pending Tranche Releases of Adjustment Operations* submitted to the Executive Directors between May 24, 1995 to October 22, 1996; January 6, 1997 concerning *Extension of Closing Date*; January 24, 1997 providing information on (1) *Closed Mills under the First Tranche*, (2) *Retrenchment of Workers under the First Tranche*, (3) *Total Retrenchment under JSAC*, (4) *Retraining Program*, and (5) *IDA's Measures Taken*; February 6, 1997 follow-up letter explaining to GOB the decision and conditions for *extension of the Closing Date*; February 11, 1997 on (1) *Macroeconomic Policies {restraint on wages and flexible exchange rate Management}*, (2) *Loss Financing*, and (3) *Privatization*.

<sup>9</sup> Current officials included the Secretary of Finance and the Secretary of the Economic Relations Division, both of the Finance Ministry; the Secretary of Jute/Chairman of the Steering Committee; the Chairman of Bangladesh Jute Mills Corporation, Chairman of the Privatization Board, and the Secretary of the Industries Ministry.



making so much time available and to the World Bank field office for logistical support.

24. Both prior to and after his consultations in Dhaka, the Inspector had extensive fruitful discussions on and relating to the Request with the Alternate Executive Director representing Bangladesh.

### C. The JSAC

#### *Report and Recommendation of the President*

25. **Objectives.** The main benefits of the credit, as described in the Report and Recommendation of the President of IDA to the Board of Executive Directors in January 1994 ("MOP") were to:

- help turn the loss making jute manufacturing sector into a smaller, but viable industry;
- eliminate the burden of jute sector financial subsidies on the economy;
- establish a market-based credit system and financial discipline in the jute industry; and
- initiate a strong privatization program of almost all government-owned mills that would demonstrate Bangladesh's commitment to a vigorous private sector development process.

26. **Reform Program.** To these ends the credit was to support the implementation of a program of reforms designed to restructure the jute manufacturing industry. The program involved:

- elimination of excess capacity in the jute industry by closing 9 of the 29

public mills and downsizing two large public mills;

- retrenchment of about 20,000 employees in the public sector;
- social safety net program for retrenched workers;
- restructuring of jute sector debt of about Tk 35 billion (US\$900 million);
- privatization of at least 18 of the remaining 20 public mills; and
- training/retraining of redundant workers.

27. **Macroeconomic Framework.** The MOP noted that the Macroeconomic framework necessary for successful implementation of the reform program was described in the annual Policy Framework Papers and the recent Country Economic Memorandum.

28. **Risks.** The MOP predicted that the program, which involved mill closures and retrenchment, was politically sensitive.

"The principal risks are labor related and political in nature. The Government will implement a comprehensive safety-net program which includes retrenchment benefits and retraining, particularly for self-employment, to support the affected employees."

29. **Design.** At the GOB's request, IDA undertook a comprehensive study of problems of the jute industry.<sup>10</sup> The reform strategy to be supported by JSAC was developed jointly with the GOB in the preparation of this report, which concluded that fundamental changes were needed to restore the industry to commercial viability. The GOB then initiated a series of reforms. Implementation of these specific actions were the condition for IDA support of the

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<sup>10</sup> Bangladesh: Restructuring Options for the Jute Manufacturing Industry. February 12, 1992. Report No. 10052-BD.

program and release of the first and subsequent tranches. Ownership and commitment to the program were reflected in the GOB's Letter of Sector Policy of December 23, 1993. The Letter outlines the actions the GOB would undertake as conditions precedent for release of further tranches of the credit proceeds.

30. **Rationale for IDA Support.** The MOP reviewed, inter alia, IDA's:

- past experience with adjustment lending to Bangladesh
- earlier projects in the jute industry
- social impact
- projected benefits, and
- risks

and concluded that: "While the proposed operation entails considerable risks, *particularly if there is slippage under the program*, the benefits associated with successful outcome justify IDA's strong support." [Emphasis added]

31. **Board Approval.** On the basis of the information contained in the MOP, the Executive Directors of IDA approved the JSAC.

### **Subsequent Events**

32. **Loan Effectiveness: April 1994.** The first tranche was released upon loan effectiveness since actions required for its release had been completed prior to IDA Board of Executive Directors' approval of the JSAC.

33. **Tranches.** The estimated date for release of the second tranche was March 1995. The conditions for its release are/were:

- maintain macroeconomic framework including wage policy in jute industry satisfactory to IDA;

- reduce excess capacity in public mills by taking the following actions:
  - dispose of equipment of 4 closed mills and equipment not required for operation of the one downsized mill;
  - close 5 identified public mills and downsize one other to reduce capacity in the public sector by 2,700 looms;
- reduce permanent employees in the public mills by an additional 8,000;
- introduce mandatory retirement age for workers in the public sector;
- restructure the jute sector debt;
- reduce GOB's share in the total loom capacity to at most 7,000 looms by privatization or other means of disposal of at least 9 mills; and
- complete liquidation of the BJC.

and for a "floating" tranche:

- offer a public mill for sale with necessary measures to make it attractive to the private sector; and
- maintain a macroeconomic framework including a wage policy satisfactory to IDA.

34. **Political Instability: May 1994-June 1996.** Shortly after credit effectiveness, progress in the JSAC reforms --as in other structural reforms--was stalled because of severe political turmoil and instability, along with the change of senior officials in the key ministries.

35. According to a recent supervision mission, during this period actions meant to allow for a smooth transition period--debt restructuring and provision of loss financing, and reductions in the labor force--had been implemented, but the main actions of closure and privatization of jute mills had not.

36. During this period, the JSAC was identified by Management as a problem. The Executive Directors were notified of the delay in releasing the second tranche on a quarterly basis, and once the delay exceeded the estimated tranche release date by 6 months, an explanation for the delay was provided.<sup>11</sup> In November 1995 the Board was informed that: "After the March 1996 elections we expect that the new government will take the needed actions, leading to the second tranche release by September 1996."

37. In February 1996, the Executive Directors were informed that:

"The Government had indicated before the elections that if it returns to power it will resume project implementation and try to get it back on track. Although most of the preparatory work for the above has already been done, the current political situation and commitment does not permit us to have a firm estimate of second tranche release date. The situation would be reassessed after the new Government resumes project implementation."

38. The June 1996 report was identical on progress but informed the Executive Directors that a mid-term review was planned for shortly after the new GOB assumed power.

39. The October 1996 report informed the Executive Directors that the new GOB's request for an extension of the Closing Date was under discussion.

40. The March 1997 report summarized the background and situation as follows:

"In August 1996 a mid-term review mission agreed with the new Government on a revised implementation timetable for JSAC, since political instability had caused substantial delays in program implementation. The main cause for delay in releasing the second tranche has been the failure of the previous Government to privatize or close 14 public jute mills as required. The new Government has already tendered 9 public jute mills and will tender 5 more mills during the first quarter of 1997. Second tranche release is expected by June 1997 since the whole process of transferring or closing 14 mills would require time."

41. **Renewed Commitment: July 1996-Mid-Term Review.** The GOB elected in June 1996 indicated its interest in continuing the JSAC and requested an IDA mission to discuss extending the Closing Date beyond December 31, 1996. IDA sent a mid-term review mission in July 1996. The review acknowledged that:

"during the JSAC period, there has been an unintended perverse shift of production from the relatively more efficient private mills to less efficient public mills, and closure of a few more efficient private mills because: (i) the public mills had generous and longer availability of loss financing and easy access to working capital, compared to the private sector; (ii) public mills have been realizing lower sale prices, compared to the pre-JSAC period when export prices were generally similar for private and public mills; and (iii) delay in closing the worst performing public mills, and privatizing the other mills; and some public mills are deferring payments to traders to sustain their

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<sup>11</sup> "Quarterly Report on Pending Tranche Releases of Adjustment Operations" SecM95-1188 of November 17, 1995; SecM96-206 of February 27, 1996; SecM96-591 of June 10, 1996; SecM96-1065 of October 22, 1996; SecM97-150 of March 3, 1997..

operations. This debt may have to be borne by GOB, as has happened in the past.”

42. More specifically, same mission reported the problems quoted in para. 13 above. And moreover, that “Under the original closure and privatization schedule for second tranche, it was expected that public mill losses would have been reduced by US\$26.5 million in FY94/95, US\$18.3 million in FY95/96 and an additional US\$8.8 million in FY96/97. However the lack of progress in privatization/closure of mills, together with wage increases and other factors, resulted in public mills losses of US\$64.5 million in FY94/95 and an expected US\$84.1 million for FY95/96.”

43. **Extension of Closing Date.**

Management decided on December 30, 1996, to extend the closing date for another six months to allow time for the Borrower to bring the program back on track. An additional extension of one year was offered if, and only if, the Borrower could undertake a set of actions with regard to privatization, disposal of assets of previously closed mills, disposal of BJC assets, and imposition of discipline of banks providing working capital to government-owned jute mills.

## D. Discussion

### **Adjustment Lending Policy**

44. OD 8.60 on Adjustment Lending Policy sets out the prerequisites for adjustment lending.

#### **Commitment to Adjustment Program**

45. As acknowledged by the Response, OD 8.60 emphasizes the need for “strong political commitment” to reform. The OD also highlights Management responsibility for evaluating the Borrower’s commitment:

*“Adjustment programs require strong political commitment, and the government concerned needs to generate broad-based support if the program is to be sustainable”* (¶ 38). and continues with:

*“The strongest influences on borrower ‘ownership’ are political stability, support (or at least lack of opposition) from the principal constituencies affected by adjustment programs, and the attitudes of government officials and technicians towards the various reforms.... Adjustment lending is not advisable when the political commitment to adjustment is weak or highly uncertain. While there are no general rules for ascertaining the strength of ownership, experience suggests that a simple indicator is the capacity and willingness of country authorities to prepare acceptable Letters of Development Policy.”* (¶ 39) These three requirements are discussed in turn below.

46. **Political Stability.** This appears to be the first and fundamental requirement for supporting a successful adjustment operation. The MOP, while recognizing that the government in power at the time had been elected in 1991 following escalating political disturbances, provided no analysis of the prospects for political stability as of the beginning of 1994. As noted above, Management has pointed out that political turmoil re-emerged early in the life of this program as well.

47. **Support for Restructuring and Privatization.** The MOP was nearly silent about support of key affected constituencies for the program. The MOP did identify a major risk, pointing out that the “program, which involves mill closures and retrenchment, is politically very sensitive. The principal risks are labor related and political in nature.”

48. The **Response** explains that the GOB's commitment was demonstrated by its taking the actions necessary for the release of the first tranche upon loan effectiveness.

49. The MOP noted that "although the current Government has clearly demonstrated its ability to reduce excess employment and close unprofitable mills, the political difficulty of sustaining this effort is considerable," (¶ 110) and explained the measures undertaken by the GOB:

"The Government has sought to manage the risks by explaining the program to the public and extensively debating the program in Parliament. The Government has tried to make the costs of industry more transparent by identifying the costs to society, specifically in the context of the jute write-off and interim financing arrangements. In order to garner support for the program from labor groups, the Government has offered generous severance payments to retrenched workers. Moreover, the Government has agreed to pay benefits to workers who do not wish to accept new employment conditions in privatized plants...." (¶ 111).

50. A year into the program, an IDA private sector development specialist provided more detailed analysis. Privatization, as anticipated, was proving particularly difficult for a variety of reasons:

- "Jute has been Bangladesh's most important agricultural and manufacturing product for years. While world demand has declined, Bangladesh's official approach has been to continue to prop up the industry through a variety of subsidies which in sum now total about US\$1 billion equivalent. No

Government has really had the courage to back away from this public support which has become to some extent, a 'matter of pride', and a 'way of life' in the country, and thus self-perpetuating.

- Although there is considerable private activity in the sector, private jute manufacturers are not politically or financially strong enough to play a major role in the necessary sector restructuring.
- As in many countries, privatization in general is not viewed very favorably by the public at large, and certainly not by the significant part of the population which earns its living through jute (in fact through Government subsidies to the jute sector).
- With elections in the not-too-distant future, politicians of all stripes are exploiting the unrest in the jute sector by encouraging labor unions and other groups to believe that if they can only delay the process a little while, maybe it will never happen. All political parties apparently give public support to the privatization program but in many cases, apparently, also give support to opponents of the process.
- The tender process of privatization may not be particularly well-suited to disposing of obsolete assets in a 'sunset' industry, particularly when assets are sold encumbered with significant labor-related obligations, and restrictions on how the assets may be used."

The memorandum goes on to explain that "as a result of all these factors, most parts of the Government appear to accept that jute restructuring and privatization will be slow. There is no obvious resistance to the program among officials charged with implementing it, but nor, in most quarters, is there much real energy being displayed in trying to overcome manifest obstacles."

51. While the analysis in the MOP was broader than the simple indicator used to ascertain political commitment provided in the Response, perhaps a more detailed description of risks in this respect might have been useful for the Executive Directors. In retrospect, Management argues that there existed a narrow time window of Borrower commitment upon which Management attempted to capitalize. The window closed quite quickly and suddenly, and yet no strategy existed for the program in case of a collapse of an important component. In particular, an analysis of borrower ownership in terms of the attitudes or commitment to privatization of key constituencies and players—such as that provided in the 1995 staff review outlined above—may have raised questions on the readiness to implement the reforms on the scale and in the time frame proposed for the JSAC.

52. Finally, macroeconomic policy measures—specifically wage policy which will be discussed below—in the context of indicators of borrower commitment or likely political ability to implement adjustment, may have deserved more detailed treatment in the MOP.

### Macroeconomic Policies

53. A further prerequisite in OD 8.60 is: *“The set of policy measures to be supported by an adjustment program has to be evaluated as part of the overall program. A clear understanding with the government on the overall stabilization and structural programs is a prerequisite for putting the conditions for tranche releases in the proper context. ...the Letter of Sector Policy (in the case of SECALs), and the corresponding policy matrices, spell out the*

*macroeconomic targets to be monitored so as to avoid misunderstandings.”* (§ 40)

54. The JSAC Letter has just one macroeconomic action: wage policy. This is reflected in the “Matrix of Policy Actions” attached to the MOP, where as a condition for release of the second tranche, the GOB was required to “Maintain macroeconomic framework including wage policy in jute industry satisfactory to IDA.”

55. With respect to macroeconomic policies, the MOP stated that the “viability of the industry critically depends on a flexible exchange rate and prudent wage policies. During the period of the Credit, the Government would be expected to maintain and implement the macroeconomic framework agreed as part of the IMF’s Enhanced Surveillance Program. Actions of particular importance are flexible exchange rate Management to maintain external competitiveness, and restraint on wages in the jute industry until the profitability of the industry is restored. By this time, the majority of the mills will be in the private sector and wages for both the private and remaining public sector workers would be linked to labor productivity at the mill level.” (§ 65)

56. The Requesters cite two macroeconomic issues as impacting on the viability of a privatized jute industry:

- sustainable wage levels that keep jute products competitive internationally, and
- a realistic exchange rate, since 90% of jute production goes into export markets.

### Wage Policy

57. The Response -- as already noted -- argues that the Borrower’s “commitment

was demonstrated by the GOB's taking the actions necessary for the release of the first tranche upon effectiveness." However a principal action taken by the Borrower months before this credit was presented to the Board, was to raise wages in the public sector (including jute mills). This action clearly undermined prospects of financing the reform program under negotiation.

58. The MOP outlined the circumstances of the 1993 "moderate" increase in public sector wages. (¶ 92) It implies that the original demand for an increase of 40% was reduced to 17%. An earlier August 1993 staff analysis showed that the 40% increase in the basic wage was awarded, but when blended into the overall pay and benefit package, the net increase was about 14%. The MOP also acknowledged that the GOB recognized the fundamental importance of wage policy to success of the JSAC: "unless the wage increases in the jute industry are restrained and the wage bill is substantially reduced, *the industry cannot be viable even if all the structural reforms outlined above are fully and effectively implemented.*" [Emphasis added] (¶ 93)

59. In the discussion on privatization the MOP noted generally that:

"Given that labor and wage issues are highly politicized in the industry, it will be a major challenge to reduce jute sector wages to levels prevailing in most private sector activities (which are currently less than one-third of those in the jute sector)." (¶ 84)

60. The MOP also expressed the hope that "the restructuring of the jute industry to be supported with the proposed credit will set an example for other industries by linking future wage increases in both the

public and private sectors to productivity." (¶ 9)

### 1993 Wage Increase

61. The Requesters state that the impact of the wage increase in the summer of 1993 was in "setting a new reference point for wages in the jute industry while directly pushing up costs for the BJMC mills, making them less viable and less easily privatized." In addition, the wage increases caused strikes among private mill workers for comparable increases, and the migration of skilled workers to the higher wage scales in public mills.

62. Regional Management recognized the damaging effect of the July 1993 wage increase. It responded by a letter of October 8, 1993, which insisted that the Borrower accelerate the planned privatization process. "Clearly IDA cannot move forward in support of the JSAC until it is in a position to satisfy the Board that any wage settlement is fully consistent with the objective of achieving viability for the public mills and that the agreed interim financing and debt relief package will be sufficient to ensure that the privatization plan can be implemented smoothly." By implication, the wage issue was important for establishing the borrower's commitment to reform. The commitment was to be demonstrated by the GOB's taking the actions necessary for the release of the first tranche upon effectiveness of the Credit.

63. It might have been useful to include in the MOP (a) an analysis of the difference between wages at public and private mills within the jute sector, and (b) a clearer analysis of the impact of the 17% increase on the viability of the private sector mills and on the prospects for privatization of the public mills under the program. Such a

detailed analysis might have indicated the financial damage of the 1993 increase, seen in staff documents, as delaying profitability in both the private and public mills for another two years. That conclusion was never reconciled with the requirement that GOB financing to the private mills was to terminate at the end of 1994 (later extended to mid-1995). Ultimately, the real damage of the wage hike was to reduce the attractiveness of the mills for privatization -- a situation only recently rectified by sacking the workers before transfer of mills to new owners. That solution probably creates additional political hurdles for any government wishing to privatize the mills.

### 1996 Wage Increases

64. Referring to the already mentioned Letter of Sector Policy, the MOP stated that "The Government's Statement of Jute Sector Policies makes it clear that further wage increases in public sector mills will be granted on a mill-by-mill basis and only when profitability permits." (§ 93) However across-the-board wage increases (10%) were introduced in the public mills again in 1996.

65. Management later reported, "The increases in wages for public jute mills, in addition to furthering the industry's problems and resulting in higher subsidy requirement, are in contravention with this condition and would therefore need to be reviewed in the context of a possible rescheduling of the project." At the same point, "the mission recommended that the Government abstain from any further increase in wages that would aggravate the situation of the industry and *further violate JSAC conditions.*" [emphasis added]

### Exchange Rate Policy

66. The MOP emphasized the need for flexible exchange rate Management. The Panel in January 1997 asked Management the following question:  
*"With regard to flexible exchange rate Management, the question does not appear to be included in the matrix of policy actions in the President's Report. Was it considered unimportant? Did a target exist for the exchange rate that would have caused significant benefits or damage to the jute industry?"*

Management explained that "IDA does not set targets on exchange rate policies, since this is an area of the Fund's expertise. In designing JSAC tranche release actions, IDA took into account that the Fund was satisfied with the exchange rate policy, as reflected in the Fund's mid-term review of March 25, 1994, which covered September and December 1993. In such review, the Fund noted that external reserves of Bangladesh were very strong and that the GOB remained committed to pursuing an exchange rate policy in line with its agreements with the Fund. IDA Management does not consider appropriate that exchange rate policies be used to compensate for particular sector competitiveness of lack thereof, and we believe Fund Management agrees."

67. The importance of the exchange rate issue was raised by the Requesters. They spoke of an "understanding" in the negotiation of the program that the Taka would gradually decline to Taka 50 = \$1 within the life of the JSAC. Since it has currently reached only Taka 42 = \$1, the industry believes that they are suffering from an effective 15-20% penalty in exports, which account for 90% of jute production.



### ***Loss Financing***

68. The initial attempt to deal with prior losses stated that financing would be provided for only 18 months -- actually 12 months given the delay of project effectiveness -- which for the private mills meant that they could be disadvantaged vis-a-vis the public mills if privatization were delayed. Management asserts that this problem is unavoidable, owing to their working "on the assumption that privatization of public mills would be fairly advanced at the end of that period." Management failed to note that privatization efforts in Bangladesh had consistently been characterized by delays. Any project design might have included mechanisms reflecting that reality, as it was likely that the private sector would suffer. The fixed deadline -- created for the obvious objective of reducing government deficits -- provided an incentive for those resisting privatization to attempt to drive the private mills out of business.

69. The Requesters allege that the JSAC failed to include a "mechanism of ensuring effective and quick implementation of the program." Financing of current losses is one example. Management accepted a standard, with regard to future loss financing, that the GOB would provide no more funding to any banks for mill losses (public or private) after June 1996. The Requesters have explained how that gives an advantage to the public mills: "WB must recognize that under any loss making situation, public sector losses must be funded in one way or the other by the Government.... For example, the banks have already been asked by the Government to provide working capital finance to public mills to the extent of 50% of last year's loan amount, as an interim measure, allowing the public mills to purchase jute and keep their

mills running despite higher costs than most private mills. It goes without saying that these amounts are non-refundable (*and are effectively loan finance*) and therefore already violate the WB conditions for FY 1996-97." The Requesters later say, "To expect that BJMC losses will remain somehow unfunded is to wish the problem away. Such recommendations only serve to act as an impediment to GOB for providing similar help to private mills."

70. Management has noted the problem of establishing discipline over provision of working capital. "Working capital financing has also not followed the JSAC agreement, under which the GOB was to ensure that those mills that were not offered for sale according to the agreed timetable and those that failed to reduce their losses were to be denied bank financing."

71. While the Borrower may be no longer directing credit to the public mills, it is evident that public mills can obtain working capital from the banking sector, the banks confident that the GOB will eventually cover the bad debts of the public mills. Private mills, however, lack comparable access. The debt restructuring of 1993-1994 under the JSAC left the private mills "uncreditworthy," and thus disadvantaged.

72. Following on these difficult issues, Management chose to change in an important way the condition related to financing. Recently Management and the GOB agreed to extend the closing date of the credit on the basis of, inter alia, "abstention from requiring banks to provide additional financing to loss-making public or private mills beyond June 1996." The word "requiring" changed the approach. Previously, Management had required that no new financing be provided or as stated in

the mission's recommendation in the mid-term aide-memoire of July 1996, "abstain from considering any additional requests for loss financing to public or private mills beyond the original date." The new language has changed the burden of proof, allowing the banking system to provide credit to the public mills, confident from past practice that reimbursement would later arrive from the GOB.

73. In response to a question on the status of this conditionality, Management explained that it recommended in a letter of September 1996 that, in addition to the concept of abstention, "working capital financing by Nationalized Commercial Banks be provided based on performance criteria in order to ensure that private mills are treated equally with public mills and that those public and private mills that are not creditworthy be denied credit." Access to credit has been a contentious issue: Requesters allege that they are inherently disadvantaged in this regard by the original debt restructuring.

### ***Training***

74. Finally, the MOP laid out a two-track training program: to upgrade the skills of workers remaining in the jute mills, and a retraining program for retrenched workers. The Requesters say that the BJMA was denied representation on the planning group -- not verifiable by the Panel -- and according to the BJMA, the resulting training program favors the public sector over the private. The first workshop was not held until April 1996, when over 20,000 workers had already been dismissed and scattered to their villages. In effect, a major opportunity for retraining workers in the promised "social safety net program" of the

MOP was lost. Nevertheless, it may be available if future privatizations occur with accompanying large-scale redundancies.

### ***Participation***

75. The Requesters cited, as a violation of policies, the unwillingness of Management "to involve, or to take seriously the concerns of, the private sector as an affected party in the design and implementation of Bank-financed projects." Since the end result of the adjustment credit was supposed to be a viable private sector, it appears to be essential to have a constructive relationship with the industry being fostered. Management maintains that consultation has been extensive from the beginning, while the Requesters maintain that they forewarned Management, during design and execution, about the kind of damage IDA's acts and omissions were causing the private mills, without getting a positive response.

76. For example, when the private mill owners were presented with the decision to carry out the JSAC program at the end of 1993 by the GOB, BJMA felt they had no choice other than to join the program, but registered their "reservations" in a letter dated January 5, 1994 to Management and to the GOB. These concerns covered: "(1) short time frame of interim loss financing; (2) attitude of banks; (3) no arrangement for funds to undertake cost saving measures; (4) no effective or real exit mechanism; (5) restriction on mills rights to manufacture yarn/twine and other diversified products; (6) blatant discrimination against private mills affecting our competitiveness." The BJMA described their concerns as "strong enough for the Association to officially put on record that without the necessary amendments which satisfactorily addresses the above issues, the private sector jute industry in Bangladesh will not be able to

deliver the desired results and JSRP will be doomed to failure."

77. The reluctant agreement of the private mill owners appears to be a participation process in which they were present, but where their views were not incorporated into the final design. Whether or not their prediction was true -- that their difficulties have been instrumental in the breakdown of the project -- it is at least clear that their prediction of the areas of potential damage to their interests was accurate.

78. The Requesters argue that, even with the weak support for the reform at the outset, the JSAC has done nothing to build any more internal support for the project. Even worse, the Requesters express concern that the entire spirit of the credit has been reversed: "We understand now that the Government has requested formally that the Bank agree to eliminate or postpone the privatization and public mill closing provisions from the JSAC agreement." There is substantial evidence in Management documentation to support this allegation. The Inspector found, in consultations with some senior GOB officials, a strong inclination to expect a further decline in private sector capacity and a related rationalization that, therefore, public sector capacity had to remain open in order to maintain Bangladesh's share of world jute markets. They recognized that such a view was contrary to the JSAC approach, but that it might be more important to maintain the volume of an industry that employs, directly and indirectly, a reported one-quarter of the country's work force.

### **Supervision**

79. **The Request** also alleges that Management has failed to supervise adequately the Program. While the Requesters do not quote directly from IDA policy, their concern appears to derive from the unbalanced nature of progress in various elements of the program. As OD 13.05, Annex A states, "Supervision should not lose sight of the intended results of the agreed actions (which should be consistent with the program's objectives) and the general macroeconomic framework within which program implementation takes place. Supervision of adjustment loans must, therefore, be broader than the review of agreed actions and procedures related to procurement and loan disbursement." In effect, the concern of the Requesters is that the private sector was perishing under the discipline of a credit that was succeeding, through only partial implementation, in fostering the public sector that was supposed to be privatized. As the Requesters allege, "The actions and omissions of the Bank in the design and implementation of JSAC provisions have resulted in the *exact opposite* of the intended JSAC objectives."

80. Management maintains that supervision of program implementation has been strong. But the documents also show that pressure from Management was not applied consistently to all project elements. In that situation, some constituencies were forced to reform more than others, e.g., the private sector has lost more access to credit than has the public sector. The nature of political forces in Bangladesh led to a gradual distortion of the "reform package," and several people consulted in the GOB maintained, rightly or wrongly, that only tighter supervision by IDA could have maintained the balance of the package.

### ***Suspension of Disbursements Policy***

81. The Request expresses concern about IDA adherence to policies, in the context of "failing to enforce JSAC agreement conditionalities which would adversely affect implementation of JSAC's key components and attainment of its objectives." Enforcement could imply the application of OD 13.40, Suspension of Disbursements. The Response argues that the tranching of adjustment disbursements makes it impossible to withhold funds except at the time of release, and that Management had done so after release of the first tranche. The difference between covenants in investment operations and conditions precedent in adjustment operations is also explained. As stated above (BOX 1), the Panel sought clarification on this issue by asking the Senior Vice-President and General Counsel for his opinion on remedies (Attachment 3). That opinion elaborates on the range of remedies noted in the Response. It appears, from discussion with Management, that the option of cancellation discussed in the above-referenced Opinion has never moved beyond the informal discussion stage.

### ***Remedial Actions***

82. The Requesters believe that some of the damage caused to them arose from Management's "apparent willingness to reconsider and modify significantly to the detriment of JSAC the content, scope and timing of the implementation plans for: public sector mill closures; downsizing of two large public sector mills; privatization of remaining public sector mills; working capital availability for private sector mills; wage policy reform and wage-level containment in the sector; and technical assistance and training to attain viable machine efficiency and labor productivity

levels in the sector." In effect, the Requesters are noting the attempts of Management to deal with a program that has encountered delays.

83. The question of tendering public mills is one example. An aide-memoire from August 1996 says that "Any possible rescheduling of the Program would require *upfront action* in the closure program as an indication of Government commitment." The goal was to close 5 mills, downsize one more, and reduce total public mill capacity by 2,700 looms. The mission had recommended closure of at least 3 mills by the fall of 1996; it was stated that "the sale transaction -- whether privatization or closure -- of at least 3 of the mills, slotted for closure, would need to be completed before we would consider extending the Credit closing date." However, Management then retrenched further, with the final agreement requiring, *inter alia*, "tender or closure of nine public mills," but not the actual completion of transactions.

84. Privatization has a limited track record in the GOB. The Privatization Board was created during negotiation of the JSAC, and according to multiple sources, was improperly staffed and never given adequate policy independence. Over the life of this program, multiple tenders have resulted in virtually no successful sales. The current issuance of tenders for nine mills is a test of the process. Consultations with the Borrower revealed that none of the tenders in recent months have been successful, and that the mills will all be tendered again, rather than being closed immediately.

85. In response to a question from the Panel, Management explained that "Target dates have been established for mill privatizations and for closure of those mills in respect of which tenders have been

unsuccessful. These target dates were agreed with the Government during the mid-term review of the JSAC. The supervision missions from headquarters will evaluate the Government's progress in achieving the privatizations and/or closures against these agreed target dates. If such evaluation concludes that the progress achieved in respect of this or any other component of the reform program supported by the JSAC is not substantial, the Closing Date (currently June 30, 1997) will not be extended. If the evaluation concludes that the progress achieved justifies a further extension of the Closing Date, this extension would only be granted against a tight schedule--possibly one year--for completing the reform program."

86. In terms of the concerns of the Requesters, the most important element of the loan extension conditions relates to the "continued financial discipline on private and public mills." To date, the Requesters argue that discipline has been applied only to the private mills. If Management is able to obtain equal treatment for the mills across the board, such a remedy will respond to much of the Requesters' concerns.

## E. Recommendation

87. Based on this preliminary review the Panel is satisfied that:

- the Request meets all eligibility criteria required under the Resolution and is within the Panel's mandate; and, more specifically

- the Requesters appear to have suffered material adverse effects during the execution of the JSAC; and
- the Panel is not satisfied that Management complied with all policies during the design and implementation of the JSAC..

88. Based on experiences of JSAC during the past three years, emerging political forces, and earlier lessons pointed out by OED, an extension of the closing date of the credit without revisiting basic design concepts with the GOB and Requesters may not be an adequate solution. Close supervision during this extension with regard to financial discipline might at least meet some of the Requesters' concerns. The closing of the program without a new approach in place, however, would presumably meet none of their expectations from the reform program. In this context an investigation would serve no useful purpose.

89. Based on the foregoing, the Panel does not recommend that the Executive Directors authorize an investigation into violations of IDA policies and procedures alleged in the Request.

ATTACHMENTS (3)  
ANNEXES (2)

# ATTACHMENT 1

## Receipt of Request

On August 6, 1996 a group of Bangladesh citizens signed and sent this Request addressed to the Inspection Panel Office in Washington, D.C. On November 13, 1996 the Requesters contacted the Panel to inquire about the processing of their Request. The Panel advised them that it had never received the Request and had to ask them to re-submit it. On November 25, 1996 the Panel notified the Executive Directors and IDA President of receipt of the Request.

The Panel subsequently learned that the World Bank mail room received the package on August 14, 1996 and mistakenly delivered it the next day to South Asia Regional Management. The document was accepted there but never forwarded to the Panel. The Panel asked Management to investigate the apparent disappearance of the document. Management had no explanation for errors and could not supply the missing Request.

This is the second time a Request has been diverted to the relevant Region and disappeared.

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: June 16, 1995

TO: Executive Directors and Alternates

FROM: T.T. Thahane 

EXTENSION: 80242

SUBJECT: Scope of the Mandate of the Inspection Panel:  
Compensation for Expropriation and Extension of IDA Credits to Ethiopia

1. With regard to document IDA/R95-83 dated May 30, 1995 on the above subject, there has been a meeting between the Inspection Panel represented by Mr. Bröder, Chairman, and Mr. Bissell, Member, on the one hand, and Messrs. Frank, Kaji, Sandstrom, Shihata and Thahane, on the other. As a result of this meeting, the attached exchange of memoranda took place between Mr. Bröder and Mr. Shihata.

2. It is clear from this exchange that agreement has been reached to the effect that (i) the Panel's mandate is limited to reviewing compliance with Bank policies and procedures with respect to the design, appraisal and/or implementation of projects as provided for in paragraph 12 of Bank Resolution No. 93-10, IDA Resolution No. 93-6; and (ii) the term "project" as used in the Resolutions and above has the same meaning as used in Bank practice.

3. With this agreement, it is anticipated that the Board can now act on the President's memorandum IDA/R95-83 for which a closing date of June 23, 1995, has been set.


cc: Mr. Bröder  
Mr. Shihata  
Mr. Frank  
Mr. Kaji  
Mr. Sandstrom



## OFFICE MEMORANDUM

DATE: June 8, 1995

TO: Mr. Ernst-Gunther Bröder

FROM: Ibrahim F.I. Shihata 

EXTENSION: 81601

SUBJECT: Scope of the Mandate of the Inspection Panel as Defined in Resolution No. 93-10  
(IDA 93-6) Establishing the Panel (the Resolution)

I refer to the discussions held today between the Inspection Panel represented by your good self and Mr. Richard Bissell and Bank Management represented by Messrs. Richard Frank, Gautam Kaji, Tim Thahane and myself.

In these discussions it became clear that in reading Mr. Frank's memorandum to the Executive Directors dated May 30, 1995 your concern was that the term "project" as it appeared in the Resolution should not be construed narrowly so as to cover only specific investments and that you were otherwise fully aware that, under the Resolution, the complaint should be related to the design, appraisal or implementation of a project financed by the Bank.

I wish to assure you that the term "project" has been broadly defined in the Bank's practice and is not limited to specific investments.<sup>1</sup> The point raised in Mr. Frank's memorandum, which does not seem now to be controversial, is that the jurisdiction of the Panel is defined in the Resolution to cover complaints regarding the alleged failure by the Bank to observe its policies and procedures only "with respect to the design, appraisal and/or implementation of a project financed by the Bank" (emphasis added). Mr. Frank's memorandum does not include any definition of the term project; nor does it imply that this term should have a narrower meaning in the context of the Inspection Panel than it otherwise has in the Bank's practice.

With this clarification and any comment you may have on it, I hope that the Board of Executive Directors, where the power to interpret the Resolution is clearly vested, will act on the memorandum submitted to it by Mr. Frank.

cc: Mr. Thahane

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<sup>1</sup> For details, please refer to my legal memorandum "Project and Non-Project Financing under the IDRD Articles" circulated to the Executive Directors on December 21, 1984 (Sec. 84-1053).



THE INSPECTION PANEL.

## OFFICE MEMORANDUM

DATE: June 9, 1995

TO: Mr. Ibrahim F.I. Shihata

FROM: Ernst-Günther Bröder

EXTENSION: 85022

SUBJECT: Request for Inspection: Compensation for Expropriation and Extension of IDA Credits to Ethiopia -- Meeting on Memorandum of the President *ad interim* to the Executive Directors and Your Memorandum of the same date.

1. I refer to the meeting yesterday between Management represented by Messrs. Richard Frank, Gautam Kaji, Tim Thahane and your good self and the Inspection Panel, represented by Mr. Richard Bissell and myself, and to your memorandum to me later on the same day. I appreciate the willingness of senior management to share their views and to discuss the Memorandum from the President *ad interim* sent to the Board on May 30, 1995.
2. At the meeting both parties stressed that according to the terms of the Resolution<sup>1</sup>, the Executive Directors have the final authority to determine whether a particular Request for Inspection is admissible or not. It was also recognized that it was up to the Panel to determine on what grounds a Request may be rejected and that in the unlikely event that Management may have a substantial disagreement with the Panel's grounds for rejecting a request there was a need to establish some procedure to resolve the matter. Therefore it was agreed that in such exceptional cases every effort will be made to resolve directly any significant controversies that may arise between Management and the Panel and, if no agreement is reached, both parties would send a joint memorandum to the Board explaining both positions and asking for guidance. This procedure might help prevent any misconceptions about the independence of the Panel and, at the same time avoid burdening the Board with procedural matters.
3. Mr. Thahane also informed us that the Secretary's Department was creating, at his direction, a new document series with regard to any Panel issues, to ensure that the Chairman of the Panel is consulted and copied on all Board documents relating to the Panel..
4. Two main issues were discussed with regard to the scope of the mandate of the Panel as defined in the Resolution. The meaning of the word "project" and the specific request relating to compensation for expropriation in Ethiopia.
5. On the first issue, you explained your views that the Panel does have jurisdiction over all projects whenever design, appraisal and implementation were involved and that SALs, SECALs and other sector operations were clearly included. This concept has been reiterated in your above-referenced memorandum.
6. With regard to the specific Request on Ethiopia, you explained that, as stated in Mr. Frank's Memorandum, the Request should have been rejected on grounds that the Panel did not have jurisdiction because the Request, as submitted, did not refer specifically to the design, appraisal

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<sup>1</sup> Resolution No. 93-10 (IDA 93-6), September 9, 1993, establishing the Panel.

and/or implementation of a project financed by the Bank. Nevertheless, we explained that such grounds and the Panel's grounds for rejecting the Request set forth in its Memorandum to the Board dated May 22, 1995 were both valid under the Resolution.

7. With regard to the subject matter of Mr. Frank's memorandum, i.e. the request for clarification from the Executive Directors, it is clear that the Panel's mandate is limited to the review of compliance with policies and procedures which relate to the design, approval or implementation of projects. It is worth noting that from the outset the Panel stated that "there were unusual features relating to the standing of the Requesters"<sup>2</sup> The Panel did not, however, enter into the merits of the application of OMS 1.28 since the Request was clearly barred by virtue of paragraph 14(a) of the Resolution. This question has now been put to the Executive Directors: we look forward to the decision which shall enable the Panel to advise potential requesters and the public accordingly.

Attachment

cc: Messrs. Thahane, Bissell and Umafia

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<sup>2</sup> See Memorandum to the Executive Directors, dated April 4, 1995.

## OFFICE MEMORANDUM

DATE: January 29, 1997

TO: Mr. Richard E. Bissell, Chairman, Inspection Panel

FROM: Andres Rigo, Acting Senior Vice President and General Counsel

A. Rigo

EXTENSION: 81782

SUBJECT: BANGLADESH - Jute Sector Adjustment Credit (Cr. 2567-BD)  
Request for Inspection  
Legal Opinion

1. In your memorandum of January 16, 1997 to Mr. Ibrahim Shihata, you requested advice concerning various remedies available to IDA under sector adjustment credits in certain situations set out in the memorandum. First, I explain briefly the contractual arrangements for adjustment operations and then reply to your specific questions.

2. The agreements for adjustment operations are different from those for investment operations in several significant ways. First, by contrast to investment credit agreements which contain covenants covering the borrower's contractual undertakings in respect of the execution of the project, there is no covenant obliging the borrower to carry out the program of adjustment measures supported by IDA through a credit. This program is described in a letter of development policy which is furnished by the member country to IDA and on the basis of which IDA makes the credit available to the borrower. Second, the financing provided is generally intended as balance of payments support. Originally, it was provided for the financing of imports, as in the case of Cr. 2567 BD, but more recently, the funds are simply transferred to the central bank of the borrower and they may be used for imports or retained as reserves. Third, because the funds are intended to be disbursed fast, the credits are usually tranching and sets of conditions are linked to the disbursement of each tranche so that there is a certain parallelism between progress in the reforms and the disbursement of the funds. On occasion, single tranche operations have been made.

3. Against this general background I proceed to reply to your questions about what remedies, aside from withholding the release of outstanding tranches, are available to IDA:

(a) *"when the Borrower... does not comply with the conditions established for the release of one or more tranches;"*

If the borrower fails to take the actions specified for tranche release:



(i) IDA is not obliged to disburse any of the proceeds of the credit to the borrower; and

(ii) if IDA determines that such failure amounts to a situation which shall make it improbable that the reform program or a significant part thereof will be carried out, it may, pursuant to the relevant provision in the Development Credit Agreement<sup>1</sup> suspend in part or in full the right of the borrower to withdraw the proceeds of the credit and 30 days later cancel the amounts so suspended if the borrower has not taken any action to remedy the situation<sup>2</sup>. If this option is followed, IDA may, under Section 6.02 (c)(i)<sup>3</sup> of the General Conditions suspend all other credits to Bangladesh<sup>4</sup>; or

(iii) by the expected date for compliance normally provided for in the letter of development policy, IDA would review the situation, including undertaking supervision missions, and may, after that, give notice specifying the actions that should be carried out within 90 days. If the borrower fails to do so by that date, IDA may cancel the undisbursed amount of the credit<sup>5</sup>.

*(b) "after having complied with such conditions [the Borrower] takes actions that are not consistent with the reform program supported by the credit and -- legally or in practice -- would amend, adversely affect or leave without effect the actions taken to meet the conditions which were the basis of IDA's prior tranche releases".*

Once the borrower has taken the actions necessary for tranche release, it is notified of the decision of IDA that it is entitled to withdraw the proceeds of the tranche concerned. If between the giving of such notice and the full disbursement of the tranche, the borrower takes actions inconsistent with the reform program, the right described in paragraph 3 (a) (ii) above is available to IDA. If these actions occur after all the proceeds of the credit have been withdrawn, the right to suspend would not be available as a remedy under the Development Credit Agreement.

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<sup>1</sup> Section 4.01 of the Development Credit Agreement (Cr. 2567 BD).

<sup>2</sup> Section 6.03 of the General Conditions.

<sup>3</sup> Section 6.02 (c)(i) provides: "the Association or the Bank shall have suspended in whole or in part the right of the Borrower to make withdrawals under any development credit agreement with the Association or any loan agreement with the Bank because of a failure by the Borrower to perform any of its obligations under such agreement".

<sup>4</sup> Neither IDA nor the Bank has exercised this right except in situations of default under the borrower's payment obligations.

<sup>5</sup> Paragraph 5 of Schedule 1 to the Development Credit Agreement for Cr. 2567 BD.

Relatively recently a new clause has been included in all development credit agreements for adjustment operations requiring the borrower to "exchange views with the Association on any proposed action to be taken after disbursement of the Credit which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program", including any action specified as a condition of tranche release. If the borrower would proceed to take such action without exchanging views with IDA, then IDA could, after a 60-day notice, accelerate the maturity of the credit under Section 7.01(c) of the General Conditions<sup>6</sup>. Credit 2567 BD precedes the introduction of this clause as a regular requirement for adjustment operations.

*(c) "[the Borrower] takes no action, or at least not sufficient action, to carry out the reform program or meet the conditions for the release of pending tranches within the dates or timetable envisaged in the reform program."*

In the final scenario indicated in your memorandum, the remedies described under paragraph 3 (a) above are applicable depending on the circumstances of the case.

4. It should be noted that the remedies available to IDA constitute contractual rights which IDA is entitled to exercise and not legal obligations that IDA must perform. Section 6.02 of the General Conditions Applicable to Development Credit Agreements (January 1985), which are an integral part of each development credit agreement, provides that if any of the enumerated events of suspension shall have occurred and be continuing, IDA may, by notice to the borrower, suspend in whole or in part the right of the borrower to make withdrawals from the credit account. Section 6.03 of the General Conditions similarly provides that, under certain specified circumstances, IDA may, by notice to the borrower, terminate the right of the borrower to make withdrawals with respect to certain amounts of the credit. Accordingly, IDA is not legally obliged to exercise any right it may have to suspend disbursements under a credit. The exercise of such right is a matter for IDA's judgment, taking into account all the circumstances of each case. IDA's decision in this as in other respects must be guided by IDA's purposes outlined in its Articles of Agreement and by its interests and the interests of its members as a whole.

<sup>6</sup>

Section 7.01 (c) provides: "A default shall occur in the performance of any other obligation on the part of the Borrower under the Development Credit Agreement, and such default shall continue for a period of sixty days after notice thereof shall have been given by the Association to the Borrower".