

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

**MANAGEMENT RESPONSE
TO
INSPECTION PANEL**

I. Introduction

A. The Request

1. On November 25, 1996, the Inspection Panel registered a Request for Inspection (the Request) submitted by a group of shareholders/CEOs of private sector jute mills in Bangladesh (the Requesters). The Requesters assert that they have been adversely affected in a direct and material way by IDA's failure to follow its policies and procedures with respect to the Jute Sector Adjustment Credit (JSAC) in Bangladesh.

2. The complaints of the Requesters may be grouped in three main categories: (a) IDA's alleged flawed design of the JSAC; (b) IDA's alleged failure to implement the JSAC effectively through its inability or unwillingness to enforce conditionalities; and (c) IDA's alleged failure to involve the private sector in design and implementation of the JSAC. While the Requesters indicate that they support the concepts of JSAC and desire its effective implementation, they assert that IDA has failed to comply with its operational policies and procedures in designing and implementing the JSAC.

3. The Requesters claim that as a consequence of IDA failure to implement the JSAC effectively and on time, the purposes of and objectives of the JSAC are not being met. Specifically, the Requesters claim that as a result of IDA acts and omissions: (a) the jute sector continues to make significant losses, with public mill losses higher than those of private mills; (b) public sector operating loom capacity remains relatively unchanged and its relative share of total operating loom capacity has grown; (c) private sector operating loom capacity has significantly decreased, while higher cost public mills remain in operation; and (d) no mills have been privatized during the four years of the JSAC program, and, in contravention to JSAC agreements, these non-privatized mills continue to receive loss financing (that is, subsidies to cover the mills' operational losses) from the Government of Bangladesh. The Requesters conclude that the acts and omissions of IDA in the design and implementation of the JSAC have resulted in outcomes which are opposite to the intended JSAC objectives.

B. The Response

4. IDA Management rejects the Requesters' contention that the design and implementation of the JSAC has violated IDA policies and procedures. The JSAC has been designed, appraised and implemented in full accordance with IDA policies and procedures. The delays in program implementation of which the Requesters complain are the result of Government of Bangladesh inaction and failure to carry out its JSAC Reform Program as set out in its Letter of December 23, 1993 (the Reform Program Letter, Attachment 1). As such, the 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, and not of IDA.¹

5. Management also rejects the Requesters' claims that IDA has been unable or unwilling to enforce credit conditionalities. We wish to state clearly that, unlike investment operations, adjustment operations do not have specific covenants regarding the Government's program for the Association to enforce. The legal structure of an adjustment operation is: (i) the Government submits to the Association a policy letter setting out its reform program; (ii) the Association determines whether it can support the Government's reform program; (iii) the Association's support is given through the release of funds when various targets of the Government's reform program have been met. If benchmarks are not met, funds are not released, but no covenants have been violated. Management and staff have repeatedly discussed with the Government of Bangladesh the deficiencies in the Government's implementation of its JSAC Reform Program as set out in its Reform Program Letter, and have continually pressed for Government to carry out its program. As a result of the Government's failure in this respect, IDA has (a) refused to release the second, third and floating tranches under the credit; (b) canceled the second supplementary credit originally proposed for JSAC; and (c) listed the JSAC as a "problem credit" subject to intensive supervision, including constant oversight from the Resident Mission in Bangladesh.

6. Although, as stated in paragraph 4 above, the complaints in respect of delays in implementation of JSAC are outside the jurisdiction of the Inspection Panel, nevertheless we wish to address all of the issues raised by the Requesters more fully.

II. Objective, Description and Implementation Status

A. Objective

7. The objective of the JSAC is to support the Government of Bangladesh in carrying out its program of reforms in the jute sector, the ultimate goal of which reform program is to create a viable, privately-owned jute industry operating on a normal commercial basis in a reformed policy environment (see Reform Program Letter, Attachment 1). At the completion of the JSAC the majority of the sector is expected to be in private hands, with the ultimate size of the industry being determined by market forces.

B. Description

8. The credit supports the implementation of the Government's program of reforms designed to restructure the jute manufacturing industry in Bangladesh². The reforms to be supported under the JSAC may be grouped in eight categories (see para. 4 of the Reform Program Letter, Attachment 1):

¹ Paragraph 14 of the Resolution establishing the Inspection Panel (Resolution No. 93-10 and Resolution No. IDA 93-6 of September 22, 1993) provides that "...the following requests shall not be heard by the Panel: (a) Complaints with respect to actions which are the responsibility of other parties, such as a borrower, or potential borrower, and which do not involve any action or omission on the part of the Bank." The Operating Procedures of the Panel provide in paragraph 2 of Part I that "The Panel is not authorized to deal with the following: (a) complaints with respect to actions which are the responsibility of other parties, such as the borrower, or potential borrower, and which do not involve any action or omission on the part of the Bank"

- (a) downsizing the industry by closing nine public mills and downsizing two;
- (b) rationalizing employment by retrenching 20,000 workers in public jute mills;
- (c) providing a social safety net for retrenched workers by paying separation benefits from Government funds and implementing a retraining program;
- (d) restructuring the debt of public and private mills and providing interim financing support for losses incurred;
- (e) privatizing 19 public sector jute mills;
- (f) reducing the share of wages in total mill revenues by retrenching excess employees, increasing productivity and restraining wage increases;
- (g) contributing to increasing productivity in mills through a training program for mill workers and managers; and
- (h) eliminating Government interventions in the jute sector.

9. The credit was available in four tranches of SDR 35 million, 50 million, 50 million and 40 million (floating tranche), respectively, with release of each tranche conditioned on the completion by the Government of Bangladesh of various actions in support of its Reform Program outlined above. Schedules 3, 4 and 5 to the Development Credit Agreement for the JSAC (the DCA, Attachment 3) specify the actions to be taken for the release of the second, third and "floating" tranches. Conditions to release of the first tranche were met by the Government of ² Bangladesh prior to presentation of the JSAC to IDA's Board of Directors. In summary, the actions required for the release of each tranche are as follows:

(a) *Conditions to Release of First Tranche:* closure of four mills and downsizing of one mill; retrenchment of 12,000 workers in public sector mills; and implementation of a debt write-off and refinancing program with banks for these closed mills and for the public sector jute trading company Bangladesh Jute Corporation;

(b) *Conditions to Release of Second Tranche:* closure of five mills and downsizing of one mill; privatization of nine mills; disposal of assets and equipment of Bangladesh Jute Corporation and mills closed under the first tranche; retrenchment of 8,000 workers in public jute mills; introduction of mandatory retirement age for public sector workers; and implementation of a debt write-off, refinancing program and time-bound interim financing program with banks for private and public mills;

(c) *Conditions to Release of Third Tranche:* privatization of nine mills and disposal of assets and equipment of mills closed under the second tranche; and

(d) *Conditions to Release of Floating Tranche:* the preparation and offering for sale to the private sector of one public-sector jute mill.

The "floating" tranche is available for release at any time before the Closing Date of the credit, once the conditions precedent for its release have been met. In addition to the specific actions outlined above and required for the release of each tranche, no tranche will be released unless the Government of Bangladesh's macroeconomic framework is satisfactory to the Association and the progress achieved by the borrower in the carrying out of the Reform Program is satisfactory to the Association.

² For details of the Jute Sector in Bangladesh see Part II, Memorandum of the President (MOP) (Attachment 2).

C. Implementation Status

10. The JSAC was approved by IDA's Board of Directors on January 13, 1994, following completion by the Government of Bangladesh of all actions required to be taken for release of the first tranche. Accordingly, the first tranche of SDR 35 million was released immediately following effectiveness of the credit on April 5, 1994.³

11. No further disbursements from the credit have been made since first tranche release, because the required actions to be taken by the Government of Bangladesh for floating and second tranche release (originally expected to be completed by March 1995) have not been completed to date. The following actions required for second and floating tranche release have not yet been taken by the Government of Bangladesh:

- (a) closure of five mills and downsizing of one;
- (b) sale of the equipment of four mills closed under the first tranche;
- (c) liquidation of Bangladesh Jute Corporation's assets; and
- (d) privatization or closure of an additional ten mills (one under the floating tranche).

Actions required for third tranche release (the privatization or closure of nine mills, originally expected by September 1996) have also not been carried out. Because of the failure of the Government of Bangladesh to implement the actions set out in the DCA, the credit has since March 1995 been listed by IDA as a problem credit.⁴

12. The DCA for the JSAC has been amended twice (amendments dated June 6, 1994 and September 12, 1995, respectively; see Attachment 4) to permit supplementary financing under the Fifth Dimension program (see footnote 3). Due to the Government's failure to accomplish the actions necessary for second tranche release, however, the second such supplementary credit was canceled by IDA effective on September 11, 1996.

13. The Closing Date for the credit is December 31, 1996. The current Government, which assumed office on June 12, 1996, has requested an extension of the Closing Date to December 31, 1998 (Attachment 5). In view of the critical importance of the reform program, its objectives and the need to restore its effective implementation, Management is considering approving the requested extension for one year to eighteen months only, if the borrower carries out certain upfront actions to bring its reform program back on track within the shortest possible time (see

³ A total amount of SDR 37.41 million was disbursed under the first tranche. The additional SDR 2.41 million was provided under the "Fifth Dimension Program", a facility which, with Board approval, allocates on an annual basis to existing IDA-supported adjustment programs in eligible countries additional resources from borrower repayments to IDA, as supplementary adjustment credits. Usually this supplementary financing is attached to the tranche currently being disbursed, or expected to be disbursed. Disbursement of the supplemental credit must be completed within twelve months of the signing of the relevant supplemental credit agreement, or the supplemental credit will be canceled.

⁴ Operations rated as unsatisfactory on development objectives or implementation progress during supervision are classified as problems. When an operation is so identified, an action plan is discussed with the borrower to deal with the issues raised by IDA supervision. In the case of JSAC, discussion of this action plan was initiated at the time JSAC was classified as a problem credit, but due to the political situation in Bangladesh it was not agreed until the Mid-Term Review mission (see Mid-Term Review mission Back-to-Office Report, Attachment 11).

Attachment 6 for Management's response). These actions, which would need to be taken before the Closing Date, are: (a) transfer of one public jute mill -- Hafiz Textiles Mill -- to the private sector; (b) tender or closure of nine public mills; (c) transfer of assets of two previously closed public mills to the private sector; and (d) abstain from considering additional loss financing to public or private mills beyond June 1996. The current Government has given assurances of its commitment to implement the reform program (Attachment 5), and its preparations for accomplishing these upfront actions are well advanced. While these actions are not sufficient to release the second tranche, they would accomplish a significant portion of the conditions.

Management will inform the Inspection Panel of the action taken with respect to extension or non-extension of the Closing Date.

III. IDA Policies and Procedures

14. The Requesters assert that they have been harmed as a result of the violation by IDA of its own policies and procedures. While the particular policies and procedures allegedly violated by IDA are not specified in the Request, the Notice of Registration issued by the Inspection Panel observes that the Requesters' allegations "seem to relate to" Operational Directives (ODs) 8.60 (Adjustment Lending Policy), 13.05 (Project Supervision) and 13.40 (Suspension of Disbursements) (attached as Attachments 7, 8 and 9, respectively). Management has identified no additional relevant directives.

15. OD 8.60 describes IDA's general policy on adjustment lending. The directive provides an overview of the nature of adjustment programs typically supported by IDA, and highlights the preconditions for designing such programs. As described in OD 8.60, IDA's adjustment lending policy emphasizes the need to conduct a comprehensive review of the country's economic policies and programs and of IDA's overall assistance strategy when designing particular operations. The appropriateness of adjustment lending in a particular country is determined in the context of an evaluation of the country's economic situation and prospects, its commitment to reform, the adequacy of the financing plan proposed, and IDA's overall assistance strategy. The main vehicle for this evaluation is the country assistance strategy (para. 37 of OD 8.60; Attachment 7).

16. OD 8.60 also emphasizes the need for strong political commitment on the part of the government, for adequate funding for the adjustment operation, and for tranche release actions to be related to the key policy and institutional reforms being supported (paras. 38, 41 and 47, respectively, of OD 8.60; Attachment 7) The directive further specifies that tranche release actions should refer to reforms within the competence of the borrower to bring about, and not to economic performance as outcome of policy changes (para. 48 of OD 8.60, Attachment 7). In respect of the number of tranches which an adjustment operation should have, OD 8.60 observes that three tranches are appropriate when the actions to be supported by the operation are expected to require a longer time to achieve (para. 49 of OD 8.60; Attachment 7).

17. The design of the JSAC fully met the conditions for designing adjustment programs stipulated in OD 8.60. As required by OD 8.60, the JSAC was appraised in the context of an evaluation of the country's economic situation and prospects (para 2, Part I and Matrix, p. 19 of MOP, Attachment 2); its commitment to reform (which commitment was demonstrated by the Government's taking the actions necessary for the release of the first tranche upon effectiveness of the Credit (paras. 59-61, Attachment 2)); and the adequacy of the financing plan proposed and

IDA's overall assistance strategy (paras. 62-64, Attachment 2). The tranche release actions agreed are within the competence of the borrower to bring about, and the number of tranches are appropriate for the reform program undertaken.

18. OD 13.05 establishes minimum supervision standards and reporting requirements to ensure consistency among operations. In respect of adjustment operations, Annex A to the directive emphasizes the importance of ensuring that supervision closely monitors the implementation of adjustment programs along with a country's overall economic performance. It is noted in the directive that certain changes in supervision emphasis are needed in view of the different nature and scope of adjustment operations as compared to traditional investment projects (para. 3 of Annex A to OD 13.05; Attachment 8). It is further noted in the directive that supervision has to focus on program execution and the timely adoption and effective implementation of the agreed policy measures and other actions (para. 4 of Annex A to OD 13.05; Attachment 8).

19. Supervision of the JSAC has also been carried out in accordance with IDA's policies and procedures, as outlined in OD 13.05. As demonstrated by the attached chronology of letters and meetings with the Government of Bangladesh during JSAC Supervision (Attachment 10), the JSAC has been closely supervised by IDA staff, with all major problems in JSAC implementation being addressed in detail and brought to the attention of the relevant Government officials.

20. OD 13.40 outlines the circumstances under which IDA may suspend, in whole or in part, the right of the borrower to make withdrawals from the credit account. Under adjustment operations, in general, the right of the borrower to withdraw the proceeds of the credit is conditional upon the continued progress in the carrying out of the reform program and the taking of the actions and measures specified for effecting the policy reforms described in the borrower's program. These actions and measures are required to be taken by the borrower to qualify for the release of the tranche. They are therefore in the nature of "conditions precedent" to the right of the borrower to withdraw the proceeds of the tranche. Failure to take these actions, therefore, means non-fulfillment of such conditions precedent which deprives the borrower of the right to withdraw the proceeds. Its implications are practically similar, in this respect, to suspending the right of the borrower to withdraws.⁵ In respect of JSAC, the first tranche was disbursed at the time the DCA became effective, but no subsequent tranches have been released by IDA due to the Government's failure to meet the tranche release conditions. Thus, the Government at present has no right to make withdrawals. It is therefore clear, in the circumstances, that IDA's determination that the conditions precedent to the release of subsequent tranches have not been met, and its consequent refusal to authorize the borrower to make further withdrawals, have the practical effect of suspending disbursement. In addition, IDA could have canceled the undisbursed amount of the credit after it had given the borrower a 90-day notice of its

⁵ Under adjustment operations, IDA has the right after reviewing the progress in the carrying out of the program, and upon giving a 90-day notice, to cancel the undisbursed amount of the credit if it is not satisfied with the progress achieved in the carrying out of the program, and actions taken by the borrower in that respect. Furthermore, every adjustment operation contains a remedy that permits the Association to suspend and subsequently to cancel the entire remaining balance of the Credit if a situation arises which "shall make it improbable that the Program, or a significant part thereof, will be carried out". The exercise of such remedy, however, is only practical if the situation contemplated by this provision has arisen after the release of the tranche, but prior to the full disbursement of its proceeds.

dissatisfaction with the progress in the carrying out of the reform program. Another alternative available to IDA is to refuse to extend the closing date beyond December 31, 1996, and cancel the amounts remaining unwithdrawn. Such course of action is highly likely to jeopardize the Government's efforts to put the program back on track and to realize its objectives which both IDA and the Requesters agree are worthy of support. Management, as noted above, continues to consider the program of critical importance to the borrower's economy and is therefore exercising every effort to support the present Government of the Borrower in its efforts to place the program back on track.

IV. Allegations

A. Design

Allegation: The design of the JSAC was discriminatory and flawed, in that it provided public sector mills with more favorable capitalization and debt restructuring vehicles than those provided to the private sector

Allegation: Private Mills Received Lower Loss Financing than did Public Mills

Allegation: Private Mills were denied Working Capital while Public Mills received uninterrupted and unconditional Working Capital, to the detriment of the Private Mills

21. The financing program under JSAG includes two components: (a) a first component to facilitate debt repayment by restructuring the existing long-term debt of both private and public mills on equal terms (existing long term debt at the time of design of the JSAC was US\$356 million equivalent for public mills and US\$203 million equivalent for private mills). Under this component, creditor banks would write off 1/3 of the debt of public and private mills, with the remaining 2/3 being rescheduled for 15 years with 0% interest and no principal repayment during the first three years, and with principal repayment during the remaining 12 years at an interest rate of 3% per annum; and (b) a second component to cover the mills' operating deficits by providing loss financing (subsidies). Loss financing was calculated for private mills on the basis of the losses of the best performing private and public mills, and was provided for a duration of 18 months. Public mills were to receive loss financing for a period of 36 months, in amounts equal to their losses during the first year, to be reduced by 15% per year during a second and third year⁶

22. The Requesters do not focus on the first component of the JSAC financing program, debt restructuring, presumably because it is the same for public and private mills. Concerning loss financing, the Requesters' complaint is that they received lower subsidies and for a shorter period of time, and that this has had an adverse effect on private mills. It is true that the reform program provides for private mills to receive lower subsidies for a shorter period of time than public mills. Loss financing arrangements were different for public and private mills because the program objectives were also different for each group. In the case of the public mills, the loss financing arrangements were designed to limit the operating losses of such mills during the period prior to privatization, since in the absence of the reform program the public sector mills

⁶ For a discussion of the financing program under JSAC, see paras. 76-83 of the MOP, Attachment 2.

would have continued to have access to public sector funding (that is, either from public sector banks or other public sector agencies). Although loss financing for public mills was to be provided for up to 36 months, on average the duration of such financing would be less than 24 months, because 14 mills were expected to be privatized or closed early during implementation of the reform program. In the case of private sector mills, the loss financing arrangements were limited to a period of 18 months, which was judged adequate to allow these mills to become competitive, while discouraging inefficient private mills from remaining in production only to benefit from government subsidies. This 18 month period was also established on the assumption that privatization of public mills would be fairly advanced at the end of that period, and the newly privatized mills would not be receiving loss financing.

23. The Requesters also assert that IDA did not ensure that private mills would receive up to 90% of projected exports value as working capital at the beginning of each year (see numbered paragraph (1) on page 6 of the Request: "Nowhere near the 90% of forecast exports proceeds suggested by the JSAC agreement were given as working capital to the private mills"). It is not correct, however, that the JSAC-supported reform program was designed to provide 90% of forecast export proceeds as working capital to public or private jute mills. It was thought inadvisable to attempt to force banks to provide 90% of working capital needs to private or public mills as directed credit, due to the negative implications this would have for the financial sector as a whole. Rather, the tranche release condition in the DCA in respect of working capital provides that the working capital requirements of public and private mills would not be financed except for such periods of time and up to an estimated amount of working capital requirements calculated in accordance with methodology satisfactory to the Association (see para. 10, Schedule 3 to the DCA; Attachment 3). Under this methodology, the 90% of forecast export proceeds was the maximum amount that could be financed, not a minimum entitlement.

B. Implementation

B.1 Enforcement of Conditionalities

Allegation: IDA is unable or unwilling to enforce the conditionalities of the JSAC agreement

24. Management agrees with the Requesters that there are serious problems in implementation of the JSAC program, and for that reason JSAC has been declared a "problem credit" (see para. 11). Such problems are detailed in the Aide Memoire of the IDA Mid-Term Review mission (see Attachment 11). Management has been continually and closely monitoring the conditions of tranche release and has declined to release the remaining tranches of the credit. As the letters to Government, Mid-Term Review Aide Memoire and periodic supervision reports (Attachments 10, 11 and 12, respectively) demonstrate, Management has continually emphasized to the Government the need to accelerate implementation of its Reform Program, as follows: (a) conveying serious concern about delays in privatization and recommending quick actions to be taken for successful tendering of nine mills for privatization (paras. 2, 3, 5, 6, 9-11 of Attachment 10); (b) providing detailed recommendations to ensure timely implementation of the debt restructuring and loss financing program (paras. 2, 4, 6 of Attachment 10); (c) repeatedly requesting that mill closures be expedited (paras. 2, 5-7, 10, 11 of Attachment 10); (d) advising on the preparation of a revised action program to bring JSAC back on track (paras. 11-13 of Attachment 10); and (e) reflecting the concerns of the Mid-Term Review mission, indicating the

perverse effects of delays in implementing the Reform Program, and recommending actions necessary for IDA to continue support of the Reform Program⁷ (para. 14 of Attachment 10).

B.2 Actions by the Borrower

25. Each of the following allegations and delays in program implementation of which the Requesters complain (namely, delays in public sector mill closures, downsizing and privatization resulting in continuing high losses of public mills, increased share in public operating loom capacity and higher than expected loss financing for public mills) with outcomes opposite to the intended JSAC objectives, is the result of Government of Bangladesh inaction and failure to carry out its jute sector Reform Program as agreed with IDA. Such delays are not the result of any action or omission on the part of IDA, and as such these complaints are outside the jurisdiction of the Inspection Panel (see footnote 1 above). Nevertheless, in the spirit of full disclosure to the Panel, we have addressed the Requesters' concerns below.

Allegation: Delays have been Experienced in Implementing Loss Financing

26. The Government delayed completion of loss financing disbursement to private mills because the latter had not contributed with financing their 1/3 share of their estimated loss financing requirements (see paragraph 10(a)(iii) of Schedule 3 to the DCA; Attachment 3). However, taking into account the situation of the private mills, IDA Management recommended that the Government finalize loss finance reimbursement to private mills by September 30, 1996, whether or not they had contributed their required 1/3 share (paras. 25-21 of the Aide Memoire of the Mid-Term Review mission; see Attachment 11). The Requesters also claim that loss financing has not been discontinued by the Government for those public mills that were to be privatized according to an agreed-upon timetable (see paragraph 10(d) of Schedule 3 to the DCA; Attachment 3). Certain of these mills have been tendered, but the process was unsuccessful (except for one mill, ownership of which is now being transferred) and the Government continued providing loss financing to these mills until June 1996.

Allegation: Mill Closures have been only partially achieved

27. The Requesters accurately state that out of nine mills to be closed under the JSAC, only four have actually been closed. The Government has been reluctant to close the remaining five mills, claiming that it wishes to avoid losing jute markets for Bangladesh, but has expressed its willingness to privatize these mills instead (see Attachment 5). In accordance with the reform program, which specifies that mills which are tendered but not sold are to be closed (see paragraph 26 of the Reform Program Letter, Attachment 1), the Mid-Term Review mission emphasized to the Government that if such privatization fails, the mills should be closed (see Mid-Term Review Aide Memoire, Attachment 11).

Allegation: Privatization has not been Implemented

28. As noted earlier, out of the 19 mills to be privatized under the JSAC, none has been privatized to date (see para. 11). IDA has repeatedly requested their tender for privatization and has provided extensive support for the process (see Attachments 10, 11, 12). The new Government of Bangladesh has expressed its commitment to implement the privatization (see

⁷ The previous Government observed that the political situation made it difficult to continue implementation until conditions improved

Attachment 5). It is now in the process of privatizing one mill and has issued tenders for nine mills.

Private Sector Involvement

Allegation: Private sector jute mills, as affected parties, were not adequately consulted during design and implementation of the JSAC, particularly in the formal decision-making meetings

29. The private sector was involved in the design of the JSAC from its inception. The Requesters acknowledge this explicitly: "We have participated in, or been informed about, studies, conferences and meetings related to the design and implementation of JSAC"(page 1 of Request). Later they admit that they "participated personally, or were represented by our private sector mill organization (BJMA), in Bank sponsored conferences and in meetings with bank staff to present our views and preferences on the content and nature of the Technical Assistance and Training component of the reform program" (page 7 of Request)⁸

30. IDA staff have gone beyond the policies and procedures and have not only consulted extensively with the private sector, but also have taken into account their comments and suggestions during the discussions of the design and implementation of the Government's Reform Program. Private jute mill owners participated in the preparatory study of the jute sector, and contributed to the design of the training program for jute workers and managers.⁹ Their views were taken into account in the design of the debt restructuring and loss financing component (See para. 30, Attachment 13). Once the JSAC was approved by IDA's Board, private jute mill owners also participated in the JSAC launch workshop (Attachment 14). Nearly every JSAC supervision mission has held meetings with the Bangladesh Jute Mill Association (BJMA, the industry association of the private jute mills) and with individual private mill owners (see Supervision Mission Reports dated May, Aug. 1994, Mar. 1995, Jul. and Nov. 1996, Attachment 12). The Mid-Term review wrap-up meeting for the JSAC, held in August 1996, included the BJMA (of which association all of the Requesters are members), which presented its views to the Government and IDA staff.

31. Not every request of the private sector mill owners was or should have been accommodated in JSAC design, and, accordingly, certain of the requests of the private sector mill owners were not incorporated in the design of JSAC: for example, in April 1993 BJMA requested that the pre-estimated losses (that for BJMA were initially based on the performance of the best five private mills) should be on the basis of industry level data (i.e., should be based on the performance of public mills also). Taking their recommendation into account, pre-estimated

⁸ The Request contains several allegations in respect of the training component of the Government's reform program (see numbered paragraph (5) on page 7 of the Request). Management observes that the training component for the reform program is funded under IDA's ongoing Sixth Technical Assistance Credit (2393BD) and not under the JSAC.

⁹ The Government's jute sector reform program was designed based on two extensive studies: (a) the Jute Manufacturing Study (September 1992) (RUMS), financed by the EEC at a cost of US\$1.6 million, with the Government of Bangladesh as Executing Agency; and (b) an IDA study entitled "Bangladesh—Restructuring Options for the Jute Manufacturing Industry" (February 1992) (IDA Study), which was used as the basis for preparing JSAC. The private sector was involved in both preparatory studies. In respect of JUMS, one of the Requesters served on the team of consultants preparing JUMS, and representatives of the private mills came to World Bank Headquarters in 1992 to participate in a conference to discuss the preliminary findings of JUMS. In regard to the IDA Study, the BJMA provided its comments to the report. In respect of the training program.

losses for private mills were considered under the JSAC based on the performance of the best five private and best five public mills. On the other hand, the Government rejected BJMA's request that loss financing be for three years for private mills. Whatever the outcome of their requests, however, private sector mill owners have been involved in all aspects of the JSAC.

V. Conclusion

32. All relevant IDA policies and procedures have been followed in the design and implementation of the JSAC, and the Requesters have failed to demonstrate that any of the harms allegedly suffered by them are the result of the violation by IDA of its own policies and procedures in either the design or implementation of the JSAC. The delays in JSAC implementation of which the Requesters complain are the result of Government of Bangladesh inaction, and are not within the Inspection Panel's purview.

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

ISSUES RAISED BY PRIVATE SECTOR JUTE MILLS

Complaint	IDA's Comments
PROGRAM DESIGN	
Loss Grant Financing (subsidies)	
<p>(a) <u>Base Year of Calculation for Loss Financing for Private Mills</u> - Should have been FY1992/93 and not FY1991/92 as used by the Government.</p> <p>(b) <u>Loss Finance Calculation</u> - For private and public mills loss financing during program design was established as the average losses of the best 5 private and 5 public mills. Instead, the approved project considered that loss financing for public mills was to be equal to 100% of actual losses during FY1993/94 and then reduced by 15% p.a. for the following two years.</p> <p>(c) <u>Period of Loss Financing</u> - It was longer for public mills with 36 months, vs. only 18 months for private mills (later extended by GOB to 24 months).</p>	<p>During negotiations the GOB decided to use FY1991/92 published operating losses to avoid that private mills overstate their FY92/93 operating losses (then unpublished) for the purpose of obtaining additional loss financing. A Committee formed by GOB and the private sector is reviewing the private mills' request.</p> <p>Initially loss financing was to be: (a) for <u>private mills</u> based on the average losses of the best performing 5 private mills; and (b) for <u>public mills</u> based on the average losses of the best performing 5 public mills. During negotiations it was modified to: (a) for <u>private mills</u> (at their request) based on the average losses of the best performing 5 private and 5 public mills; and (b) for <u>public mills</u> equal to 100% of the mills' losses reduced by 15% p.a. (in order to account for the impact of recent public wage increases).</p> <p>Loss financing (subsidies) for private and public mills had different objectives: (a) For <u>public mills</u> it was intended to enable the mills to remain in operation until privatized. If the privatization/closure schedule would have been followed, loss financing for public mills would have been on average less than 24 months (delays in implementing the privatization/closure schedule have resulted in 36 months loss financing); (b) for <u>private mills</u> the intention was to provide these with an incentive to remain in the industry while discouraging inefficient private mills from remaining in production only to benefit from loss financing subsidies.</p>
PROGRAM IMPLEMENTATION	
1. Loss Grant Financing (Subsidies)	
<p>(a) <u>Loss Financing Disbursements</u> - These are being delayed for private mills but paid ahead of schedule for public mills.</p>	<p>As of July 1996, the GOB had not completed loss financing disbursements to private mills because their shareholders had not contributed with their required 1/3 share to cover operating losses. IDA's mid-term supervision mission (July 1996) recommended that the Government finalize these disbursements by September 1996. (see Mid-Term Review Aide-Memoire).</p>

Complaint	IDA's Comments
<p><u>(b) Public Mills Not Offered for Sale on Schedule Should not Receive Loss Financing</u> - This condition has not been enforced.</p> <p>2. Mill Closures</p> <p><u>9 public mills were to be closed</u> - Only 4 public mills have been closed while 9 private mills had to be closed at different times.</p> <p>3. Privatization</p> <p><u>18 public mills were to be privatized</u> - None of these mills have been privatized to date.</p> <p>4. Disposal of Equipment of Closed Mills</p> <p><u>The Assets of the 4 closed mills were to be disposed off.</u> The Government has failed to dispose of the equipment of the 4 closed mills as agreed under JSAC.</p>	<p>The DCA [Schedule 3, para 10 (d)] states that public jute mills not offered for sale under the program should be declared ineligible for loss financing. However, most mills were offered for sale although responsive bids were received for only one of them (now being transferred).</p> <p>IDA has repeatedly requested GOB to close 5 additional mills (see supervision mission reports). Inaction to do so is the GOB 's responsibility and not IDA's. In July 1996 the Government indicated its reluctance to close the mills to avoid losing markets for Bangladesh, but expressed its willingness to privatize them. <u>IDA has not released the corresponding (second) tranche</u>, which is the only enforcement measure for adjustment credits (see attached Mid-Term Review Aide-Memoire).</p> <p>IDA has repeatedly requested GOB to implement the privatization program and has provided consultants and extensive advice. Delays in the privatization is GOB's responsibility and not IDA's. <u>IDA has not released the corresponding (floating and second) tranches</u>. The new Government has indicated its commitment to implement the program and has taken the following measures: it is in the process of transferring 1 mill to the private sector, and has recently issued tenders for 9 mills. The remaining mills will be tendered during 1997 (see attached Mid-Term Review Aide-Memoire).</p> <p>IDA has repeatedly requested GOB to dispose of the assets. Delays in their disposal is GOB's responsibility and not IDA's. <u>IDA has not released the corresponding (second) tranche</u>. The new Government has indicated that it is in the process of transferring the assets of 1 closed mill to private buyers and tendering the assets of 2 other closed mills (expected to be transferred by the end of 1996). The remaining mill is under litigation.</p>

Complaint	IDA's Comments
<p>5. Start-up of the Jute Sector Reform Program</p> <p><u>Start-up Programmed for July 1, 1993</u> . It started instead in April 1994 through a launch workshop.</p> <p>6. Debt Restructuring</p> <p><u>Debt Restructuring to be Implemented in July 1, 1993</u> . It was implemented instead in December 1994.</p>	<p><u>ISAC was only approved in January 1994</u> and the launch workshop was started soon thereafter.</p> <p><u>Debt restructuring was implemented on time according to the DCA [Schedule 3, para 10 (f)]</u>, which indicates that the Borrower should ensure that beginning December 31, 1994 participating banks must have terminated the debt write-off, restructuring, and interim financing arrangements.</p>