ICR Review
Operations Evaluation Department

Report Number: ICRR11353

1. Project Data:		Date Posted: 08/19/2002		
PROJ ID:	P044804		Appraisal	Actual
Project Name:	Rural Devt	Project Costs (US$M)	19.0	22.4
Country:	Latvia	Loan/Credit (US$M)	10.5	9.1
Sector(s):	Board: RDV - Banking (60%), Micro- and SME finance (19%), Central government administration (17%), Sub-national government administration (2%), General finance sector (2%)	Cofinancing (US$M)	6.55	10.3
L/C Number:	L4380			
		Board Approval (FY)		99
Partners involved:	EU, UK and others (?) not identified in ICR	Closing Date	06/30/2001	12/31/2001

Prepared by:	Reviewed by:	Group Manager:	Group:	
Anthony J. Blackwood	Christopher D. Gerrard	Alain A. Barbu	OEDST	

2. Project Objectives and Components

a. Objectives

The project was the first phase of a **two-phase Adaptable Program Loan to transform the rural sector compatible with EU standards** (PAD, para. 37). It had a general and open-ended primary development objective and five secondary objectives (PAD, para. 23):

Primary objective:

- Lay the groundwork for **increasing income levels and improving living standards** of the rural population by promoting **diversification and growth** of economic activities in rural areas.

Secondary objectives:

- **Strengthen policy formulation capacity** for rural development strategies at national, regional, and local levels of government;
- Introduce **participatory approaches** to rural development to increase stake-holders' ownership and commitment;
- Provide credit and technical assistance to **generate employment and income earning opportunities** in rural areas
- Further strengthen **rural banking practices and rural business development service network** consistent with principles applied in the EU; and
- Expand support for the development of the emerging **land market** and legal registration system of private land and real estate.

The PAD objectives were not fully reflected in either the LA or the ICR but are used here to evaluate the project's outcome. Understanding the objectives of the project would have been assisted by the PAD being less complex and more consistent in describing the strategy and program objectives (two phases), project objectives, followed by seven M&E indicators and finally nine "triggers" for proceeding to the second phase of the APL. Moreover, the eight "specific goals of the Rural Development Program" listed in the Letter of Development Policy (PAD Attachment 1) contain additional features and priorities. The triggers are in Section 4 below.

b. Components

The project had three components:

- **Rural Development Policy** (US$1.0 million/5 per cent of total costs) -
  (a) Development of National and Regional Rural Development Strategies, and
  (b) Development of Rural Development Strategies at the Local Level.
- **Rural Finance** (US$15.5 million/US$/82 per cent) -
  (a) Commercial Credit Line, and
  (b) Special Credit Line for Small-Scale Rural Enterprises.

- **Institutional Development** (US$2.5 million/13 per cent) -
  (a) TA for Institutional Capacity Development, and
  (b) Land Reform and Creation of Land Market.

c. Comments on Project Cost, Financing and Dates

The project was funded by the first phase of an Adaptable Program Loan (APL). The Bank loan was fully disbursed but with the Bank funds for the first and third components reallocated to the second component (Rural Finance) as the government and donors fully funded the other two components. The government did not take up the second phase of the APL as it had adequate alternative funds.

3. Achievement of Relevant Objectives:

The project achieved its major objectives except for a few shortcoming, most notably the failure to initiate privatization of the state-owned Mortgage and Land Bank (MLB) which made half the subloans.

4. Significant Outcomes/Impacts:

The impact in the longer term of the first and third components with their institutional focus, which attracted more alternative funding than planned (releasing Bank funds for subloans), may be greater than the subloan program which took most of the funds.

The ICR reports that **eight of the nine triggers were achieved** : (a) formulation of a rural development strategy and a supporting action program; (b) policy reform, training and workshops and the establishment of a policy forum involving key ministries, NGO, think-tanks, and representatives of private interests; (c) [not achieved] initiation of the privatization of the MLB; (d) successful introduction of commercial bank rural finance (at least two participating financial institutions - PFIs); (e) 75% disbursement of the first phase credit line operation with demonstrated financial viability of sub-projects and sound portfolio quality of PFIs; (f) a significant number and diversity of activities financed under the Special Credit Line (minimum 500 sub-loans); (g) establishment of a minimum of ten Local Action Groups and initiation of training for Local Action groups (LAG); (h) maintenance of satisfactory agricultural policies and agricultural subsidy program with Government's commitment not to reverse its reform direction in the future; and (i) a review of the RDP credit guarantee and capital grants schemes with a view to phase out or modify if appropriate.

Based on field enquiries and bank records, the project increased income levels, improved living standards and generated employment and income earning opportunities through diversification and growth; policy formulation capacity was strengthened as planned; participatory approaches to rural development have been initiated with the forming of over 100 LAGs; rural banking practices focused on collaterized loans for a wide range of enterprises (credit program performance indicators are excellent); rural business development services were strengthened; and project inputs and the use of land as collateral for loans supported the emerging land market.

5. Significant Shortcomings (including non-compliance with safeguard policies):

Although the project in general met its objectives as phrased, the degree of development of a sustainable rural financial system was less than proposed at appraisal and remains fragile in some respects (particularly the limited commercial bank participation). A number of aspects will require attention if commercial financial services are to be generally and widely available to the rural population, especially in depressed areas. Significant shortcomings were -

(a) The government deferred privatization of MLB (an important objective and condition for proceeding to Phase Two) until at least 2005. This undermined the major objective of establishing commercial rural financial services, and discourages other commercial banks from entering such business. Only half the relatively few loans made were by the two commercial banks (of 22 in the country) and one bank made 80 per cent of those loans, despite strong incentives.

(b) There were strong financial incentives for commercial banks to participate : a government capital subsidy to borrowers of 30 per cent of subloans conditional on repayment, a government guarantee on 21 per cent of subloan amounts, and spreads varying between 5-10 per cent. It is questionable whether sustainable commercial rural finance has been initiated through the project by this means and that these arrangements were financially "non-distortionary".

(c) Although a third of SCL loans were targeted to depressed regions, the credit line was limited in reach (which is typical for public credit schemes) in that the number of subloans was only 1.1 per cent of total registered land holders overall.

(d) The direct poverty impact of the special targeted SCL credit was limited as all loans were fully collaterized with real property and were fairly large (averaging $3,200). The intent to target poor borrowers "who lack collateral" was not pursued so that the development of banking skills for supervised credit to the poor was not realized. Hence there is concern as to whether the project design (and thus results) adequately addressed rural poverty given the seriousness of the problem (see Lesson 11, page 17 in the ICR) and the Bank's primary corporate goal.

(No information in ICR on compliance with safeguard policies.)

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Highly Satisfactory	Satisfactory	The failure to privatize MLB is a major shortcoming and the rural financial system is less firmly established than expected at

			appraisal.
Institutional Dev .:	High	Substantial	- ditto -
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

(a) Although a truism, the value of property ownership (hence land titling especially) and a transparent property market to facilitate small-scale collaterized lending was well demonstrated; and (b) Rural financial operations can be jump-started with subsidies to attract both borrowers and banks to participate, but this may risk undermining and constraining the growth of sustainable commercial lending in the longer term .

8. Assessment Recommended? ● Yes ○ No

Why? The claim of establishing a sustainable commercial rural financial system with substantial subsidies to both banks and borrowers merits review in the field . Also the applicability of the situation for an APL approach would be worth examining.

9. Comments on Quality of ICR:

The ICR is generally satisfactory, being comprehensive in most respects and well written, but for the following : the sub-objectives (priorities) were incomplete and differed somewhat from those in the project documents (especially in not mentioning EU standards); the claims for the project's achievements through the credit line are generous given the subsidy arrangements and in comparison with the relatively limited coverage; the overarching program objective, the compatibility of project achievements with EU standards, is not explicitly and adequately addressed, although several references acknowledge that requirement; despite cofinancing providing all funds for the important first and third components (to the exclusion of the Bank), there is inadequate information in the ICR on these partners (including that cofinancing is not acknowledged in the standard blocks in the ICR format); and the purpose and utility of the column "Projected in last PSR" in the indicators table in Annex 1 is not clear.