



1. Project Data:		Date Posted : 05/13/2002	
PROJ ID: P035781		Appraisal	Actual
Project Name: Moldova Rural Finance	Project Costs (US\$M)	6.1	7.00
Country: Moldova	Loan/Credit (US\$M)	5.00	4.90
Sector(s): Board: RDV - Micro- and SME finance (96%), Central government administration (4%)	Cofinancing (US\$M)	1.10	1.90
L/C Number: C3031; LP314			
	Board Approval (FY)		98
Partners involved : GTZ, IFAD, DFID, Dutch Government, CNFA., Soros Foundation, Fincombank, Women's World Banking, Open Society Institute	Closing Date	06/30/2000	06/30/2001
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2. Project Objectives and Components

a. Objectives

The project was designed at a time of accelerated land reform and farm restructuring in Moldova . The primary project objective was to develop and test a cooperative rural banking system that would efficiently provide financial services to small private farmers and rural entrepreneurs . In so doing, the project was to test a mechanism to overcome the two most important impediments to financing in the rural sector ---high transaction costs due to small loan size and lack of traditional collateral . The project was processed as a LIL to be implemented over a two year period and was to be followed by a larger project . The experience gained and lessons learned under the project were to contribute to the design of the Savings and Credit Association (SCA) component of the larger project .

b. Components

As designed the project had four components . i) development of SCAs; ii) establishment of a regulatory body for the SCAs; iii) establishment of the Rural Finance Corporation (RFC); and iv) financing of a rural credit line to SCAs . Project objectives remained unchanged during implementation . However, extremely important modifications were made in project design . By early 1998 the RFC was facing stiff competition from commercial banks which had started lending their own resources to SCAs without any special requirements concerning capitalization or risk funds . Therefore an IDA supervision and launch mission agreed to delete the mutual guarantee requirement of SCA members, substantially reduce the capitalization requirement of RFC by SCAs and eliminate a provision to create a risk fund in the form of preference shares to be subscribed by borrowing SCAs . It is not clear from the ICR document whether the implications of the modification in design on the financial viability of RFC and SCAs was given adequate attention at that time .

In addition, because of the availability of other donor financing for the technical assistance and institution building components, about US \$ 150,000 equivalent was re-allocated from other activities to the credit line .

c. Comments on Project Cost, Financing and Dates

Actual total project costs were US \$ 7.00 million equivalent against the appraisal estimate of US \$ 6.1 million of which the Bank credit was US \$ 4.90 million. Cofinancing increased from US \$ 1.10 million at appraisal to US \$ 1.90 million at closing because of the availability of resources from several other donors . The project was appraised in September 1997, became effective in May 1998. Mid term Review was held in April 1999 and the project closed in June 2001.

During implementation the domestic currency devalued by more than 100 percent which led to the substantially smaller average loan size of around US \$ 200. Even though the loan size remained relatively unchanged in local currency, the LIL was able to support more than double the number of SCA members originally projected . In addition one of the major commercial banks provided loans to SCAs with its own funds . Both these factors led to extension of the credit closing date by one year to June 2001.

3. Achievement of Relevant Objectives:

Though PAD projections were surpassed for creation of SCAs, an efficient and sustainable financial system has not yet been established.

4. Significant Outcomes/Impacts:

- The project demonstrated that SCAs can provide access to institutional financing to small farmers and rural entrepreneurs and can retail credit services with funds borrowed from financial institutions;
- Credit provided by SCAs has afforded farmers the possibility of free choice to buy farm inputs and other requirements on the open market thus reducing their dependence on the former collective structures;
- The creation of SCAs demonstrated new ways of organizing small farmers for the provision of other services of common interest such as input supply, agroprocessing etc .
- A large percentage of beneficiaries were women .

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

The project has not yet demonstrated the establishment of an efficient and sustainable financial system.

- Saving mobilization by SCAs has been negligible . In the absence of any significant saving mobilization the SCA system has evolved into a group lending operation rather than a saving and credit system;
- The slow progress in mobilizing savings also did not allow for sufficient testing of other financial services;
- Beneficiary participation in the share capital of RFC did not materialize;
- Though it was envisaged that both working capital and medium term lending for investments would be made under the project, for various reasons, so far only short term loans for a period of one year have been made .

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Satisfactory	Moderately Satisfactory	The project has not yet demonstrated the establishment of an efficient and sustainable financial system . It is noted however that the project is a LIL and the lessons in the ICR suggest that the project 'learned' enough to 'fix' these problems for the future .
Institutional Dev .:	Substantial	Modest	There is still a long way to go to establish an efficient and sustainable financial system.
Sustainability :	Likely	Non-evaluable	Sustainability depends on several factors which have still to be taken into account : (i) establishment of a sound capital base for RFC and SCAs; (ii) introduction of measures to mitigate the lending risks of financial institutions; (iii) saving mobilization by SCAs and strengthening of existing SCAs; (iv) Introduction of service fees for SCAs; (v) further strengthening of SSB, the State Supervisory Body, for SCAs and reinstatement to the SSB of its original functions and responsibilities which were revoked by the amendment to the Law of Licensing enacted in the Fall of 2001; (vi) maintenance of real positive interest rates for loans.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Unsatisfactory	

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

7. Lessons of Broad Applicability:

The project is a LIL and it is important that the lessons identified by the ICR which are extremely relevant for the future sustainability of project activities are given serious attention in the design of the follow -on project. Five lessons from the ICR are repeated here. (i) **Share Capital of RFC and SCA** . For institutions like RFC and SCAs, establishing a sound capital base should be priority . Before expanding lending, capitalization of RFC and actions to mitigate the lending risks of RFC and the SCAs need to be taken; (ii) **Donor Coordination** . The abundance of donor funds, from a large number of different sources with different objectives, has undoubtedly led to higher operational costs and

weaker budgeting and controls. To ensure sustainability and reduce reliance on donor funds, stronger coordination and cooperation between all participating agencies with clearly defined roles and responsibilities to prevent overlapping and duplication need to be assured; (iii) **Introduction of Service Fees**. While justifiable for the inception period, free training and free post-creation support services cannot be sustained indefinitely. After a certain period following establishment and licensing, SCAs should be required to pay an annual fee for the services of the SSB. In addition, continued technical assistance provided to SCAs should be fee-based. A portion of these fees payable to service providers could come from the lending margin of participating financial institutions, as was envisaged at appraisal of the project; (iv) **Financing of RFC**. When a subsidy provision is provided in the project for a financial intermediary, there should be a clear sunset clause with a specific financial target for the financial institution to adhere by and phase out the subsidy. Although intentions were good, the provision of an interest free subordinated loan to RFC lacked justification. This loan resulted in an implicit continuous subsidy to RFC, an undue advantage when competing with other financial institutions and unearned benefits to its shareholders. In the future, there may be sound reasons to provide additional subordinated loans to RFC to facilitate raising of funds on the market; however, such loans should be at customary lending terms in respect of repayment periods and interest. (v) **Strengthening of the State Supervisory Body**. Supervision and regulation of the State Supervisory Body of SCAs is critical for the sustainability of the SCA system.

The ES adds the following lesson: The abundance of donor funds can also generate a sense of complacency and can weaken the will to become self sustainable quickly. Donors should be aware of this and should provide grant resources only when they are strictly required and not as a matter of routine.

8. Assessment Recommended? ☒ Yes ☐ No

Why? An immediate audit is recommended for two main reasons: (i) The project is a LIL and the experience gained and lessons learned under the project are to contribute to the design of the Savings and Credit Association (SCA) component of a larger project; (ii) To verify the outcome, sustainability and institutional development impact.

9. Comments on Quality of ICR:

The ICR is rated unsatisfactory. It raises a lot of questions that it leaves unanswered. Since the LIL is to contribute to the design of a larger project the ICR should have given sufficient attention to the following factors: (i) More information on real interest rates should have been provided. The evidence in the ICR is not enough to show whether real interest rates were positive or negative over the time period of the project; (ii) Though project objectives remained unchanged, substantial changes were made in project design. There is no indication in the ICR of how the altered design affected the financial viability of the RFC. The altered design also made the PAD projections on the financial conditions of RFC and SCAs totally redundant. A complete analysis of the financial conditions of the RFC and the SCA should have formed a part of the ICR. (iii) There is no information on Borrower compliance with loan conditions and whether it was satisfactory or not.