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**Report No. 20770**

# PERFORMANCE AUDIT REPORT

# HUNGARY

# PRODUCT MARKET DEVELOPMENT PROJECT
**(Loan 3509-HU)**

**September 5, 2000**

*Sector and Thematic Evaluation Group*
*Operations Evaluation Department*

## Currency Equivalents (annual averages per US$)

Currency Unit = Hungarian Forint

| | |
|---|---|
| 1992 | 79.00 |
| 1993 | 82.76 |
| 1994 | 104.15 |
| 1995 | 114.30 |
| 1996 | 132.50 |
| 1997 | 176.48 |
| 1998 | 214.28 |
| 1999 | 241.44 |

## Fiscal Year

Government: January 1- December 31

## Abbreviations and Acronyms

| | |
|---|---|
| ES | Evaluation Summary |
| ICR | Implementation Completion Report |
| IBRD | International Bank for Reconstruction and Development (World Bank) |
| ITCB | International Training Center for Bankers |
| LPC | Logistics Promotion Center |
| NBH | National Bank of Hungary (Central Bank) |
| MOA | Ministry of Agriculture |
| MIS | Market Information System |
| MIT | Ministry of Industry and Trade |
| OED | Operations Evaluation Department (World Bank) |
| PMDP | Product Market Development Project |
| PRSAP | Private Sector Action Plan |
| PUSAP | Public Sector Action Plan |
| TA | Technical assistance |
| SAR | Staff Appraisal Report |

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|---|---|---|
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**The World Bank**
Washington, D.C. 20433
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ROBERT PICCIOTTO
Director-General
Operations Evaluation

September 5, 2000

**MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT**

**SUBJECT: PERFORMANCE AUDIT REPORT ON HUNGARY**
**Product Market Development Project (Loan 3509-HU)**

Attached is a Performance Audit Report prepared by the Operations Evaluation Department (OED) for the above project. The Product Market Development Project (PMDP) was supported by Loan 3509-HU for US$100 million, approved on July 13, 1992. The total project cost was expected to be US$254.5 million. The project closed on June 30, 1998, as scheduled. A total of US$59.4 million of the loan was cancelled in four instances between May 1997 and closing. The final project cost was US$88.3 million, of which IBRD financed US$40.6, the Netherlands government provided a grant of US$2.1 million, the participating banks financed US$1.7 million, and the beneficiaries' share was US$43.9 million.

The overall objective of the project was to strengthen the operational and pricing efficiency of product markets and, thereby, to improve the business environment so that producers and trading companies would be able to adjust efficiently to changing market conditions. The project had two components: a financial assistance component with a line of credit aimed at a broad range of investors to undertake activities to strengthen their logistics-related operations, and a technical assistance (TA) component to support the implementation of actions to enhance the operational efficiency of product markets and the enabling environment for investing in activities promoted by the project. The TA sub-component's actions were part of the Public and Private Sector Action Plans, developed during project preparation, which identified key areas of policy, institutional and regulatory change needed to make Hungarian products more competitive at home and abroad.

The project's objectives were highly relevant at the time of project appraisal. The project's quality at entry was highly satisfactory for the technical assistance component. For the line of credit, the project design was responsive to the lessons emerging from the Bank's experience in Hungary, but the sub-sectoral restrictions on the types of investments that could be financed under the project was questionable. Whether the targeting in fact reduced the efficacy of the line of credit, however, is difficult to ascertain as several other factors contributed to the slow disbursements.

The line of credit started off with brisk disbursements and provided much-needed capital to newly emerging small and medium private enterprises. Over time, with a rapidly changing economic and institutional environment, disbursements declined and came to a standstill by 1997. The lags in disbursements led to a series of four cancellations. Many factors contributed to this outcome, including the non-competitiveness of PMDP with other bilateral and multilateral credit lines that allowed greater flexibility in the end-use of funds (specifically the financing of used assets and real estate). These other credit lines were also more attractively priced as a result of subsidies, and were less demanding on participating banks and sub-borrowers. The sub-projects that were financed by PMDP were financially viable, however, and the sub-portfolio performance has been satisfactory.

The major contribution of the project has been the indirect impact of it's TA program rather than the direct impact of its line of credit. The Hungarians consider the unquantifiable benefits from the TA, provided during the project's preparation as well as through the TA component, to considerably outweigh the physical impacts. The regulatory and institutional changes promoted by the project have contributed significantly towards the improved competitiveness of Hungarian products in domestic and international markets, and have helped Hungary get ready for its accession to the European Union. Substantial progress has been made towards the project's main objective of improved operational and pricing efficiency of product markets. Although the project can by no means be credited for all of the successes Hungary has enjoyed so far, it has contributed to the development of Hungarian product markets, and significantly so according to the officials met during the audit mission.

The Implementation Completion Report assessed project outcomes as satisfactory and likely to be sustained; it found the project's institutional development impact to have been substantial, and Bank and borrower performances to be satisfactory. The Evaluation Summary by OED, based on the information in the ICR, disagreed on four of the ratings: outcome (unsatisfactory), sustainability (uncertain), institutional development impact (modest), and Bank performance (unsatisfactory). With the benefit of additional information and with a greater appreciation of the project's role, and the historical sequence and context in which it was appraised and implemented, the PAR reaffirms the ICR ratings. It finds that despite the low utilization of the line of credit, the project substantially met its objectives. It has played a strong "catalytic" effect in promoting institutional development and downstream investments in logistics-related activities through improvements in the enabling environment and a greater awareness of logistics management.

The main lessons from the project are: (a) Good technical assistance, especially during project preparation can significantly contribute to the development impact of Bank operations, including by having a catalytic effect on other developmental and private sector resources. (b) The Bank needs to refine some of its policies, specifically the restrictions on the end-use of its funds, to make them contextually relevant and avoid a conflict between its major objectives (privatization in this instance) with policies (financing of used assets), especially in the context of transition economies. (c) To become more competitive, the Bank needs to properly assess the expected benefits from conditions imposed on projects such as complex eligibility criteria, reporting requirements and overly complex procurement guidelines against the implied transactions cost for on-lending institutions and sub-borrowers.

Attachment

# Contents



This report was prepared by Madhur Gautam (Task Manager). William B. Hurlbut edited the report. Marcia Bailey provided administrative support.

# Principal Ratings

| | ICR[1] | Evaluation Summary | Audit |
|---|---|---|---|
| Outcome | Satisfactory | Unsatisfactory | Satisfactory |
| Sustainability | Likely | Uncertain | Likely |
| Institutional Development | Substantial | Modest | Substantial |
| Bank Performance | Satisfactory | Unsatisfactory | Satisfactory |
| Borrower Performance | Satisfactory | Satisfactory | Satisfactory |

# Key Staff Responsible

| | Task Manager | Sector Manager | Country Director |
|---|---|---|---|
| Appraisal | K. Nadkarni | R. O'Sullivan | K. Dervis |
| Midterm | K. Nadkarni | M. de Nevers | F. Kaps (Acting) |
| Completion | H. Kim | K. Cleaver | R. Grawe |

1. The rating for project outcome in the ICR Summary of Assessments (Table 1) is satisfactory. The text of the ICR, however, rates outcome as marginally satisfactory.

# Preface

This is a Performance Audit Report (PAR) for the Product Market Development Project (PMDP) in Hungary. Loan 3509-HU in the amount of US$100 million was approved in July 13, 1992, and made effective on November 18, 1992. The total project cost was estimated at appraisal to be US$254.5 million. The difference between the project costs and IBRD loan was to be financed by the participating banks (US$100 million), beneficiaries (US$51 million), cofinancing institutions (US$2.5 million – unidentified at the time of appraisal), and the Government of Hungary (US$1.0 million).

The project closed on the scheduled date of June 30, 1998. Final project costs were US$88.3 million, of which IBRD financed US$40.6 million. The remainder of the loan, totaling US$59.4 million, was cancelled in four instances between May 1997 and the closing date of June 30, 1998. The Government of the Netherlands provided a grant of Dutch Guilders 3.9 million (US$2.1 million equivalent) for technical assistance. The government did not finance any costs, while the contribution of participating banks was only US$1.7 million. The share of beneficiaries was US$43.9 million.

This PAR is based on a review of the Staff Appraisal Report, the Credit Guarantee Agreement, Bank Supervision reports, correspondence files, project and related background reports and documents, internal Bank memoranda, discussions with Bank staff, and fieldwork by an OED mission in January 2000.

OED is grateful to the Government of Hungary, particularly the National Bank of Hungary and other agencies associated with project implementation, for the cooperation and assistance they extended to the OED mission during preparation of this PAR.

Following standard OED practice, a draft of this report was sent to the borrower for comments. The borrower's response is attached as Annex C.

# 1. Introduction

The Product Market Development Project (PMDP) was conceived and prepared during a period of significant political, social and economic changes in Hungary. In the mid-1980s, the government introduced domestic and foreign trade reforms, liberalized prices, and relaxed controls on trading rights with a view towards establishing a market-based economy. Significant changes in the institutional and legal infrastructure were also initiated to allow the private sector to develop and for the markets to function properly.[1] The economic transition was expected to be slow, with gradual liberalization of policies. However, the first democratically elected government in 1990 accelerated the transformation process by introducing deeper reforms with the clear vision of a predominantly private, market economy, well integrated into the world economy.

The changes in the 1980s provided a framework for the efficient allocation of resources in a growing private sector-based economy. However, one important area – the marketing process – saw little progress, posing a serious constraint to the transmission of efficiency gains from price and trade liberalization. The key impediments to improved marketing efficiency, as noted in the Staff Appraisal Report (SAR), were poor logistics management, capital constraints (especially for medium- and long-term investments), and training and advisory services.

To address these issues, the World Bank (henceforth IBRD) organized a series of four country visits from 1989 to 1992 to help Hungarian public and private sector entities formulate the PMDP. By appraisal (January 1992), many of the reforms were in place, but the economic conditions were not optimal with the collapse of the Council for Mutual Economic Assistance (CMEA) and the Gulf crisis of 1991. The economy was in a recession, exports had declined, and inflation was high. Nevertheless, with a reform-minded government in place and opening up of the economy, the outlook was promising and foreign investment was starting to flow in.

PMDP was the first project targeted at the trade sector in Hungary, and was a pioneering project for IBRD in the field of logistics management. It was conceived as an agricultural sector operation, but by appraisal its scope had broadened to include all product markets, with emphasis on consumer goods.[2] The main component of the PMDP was ostensibly the line of credit (LOC), accounting for over 98% of project costs. The second component was the technical assistance (TA) program, and although it accounted for only a small proportion of project costs, it was substantively significant.

The main rationale for this audit was the disagreement between OED and the region on the project's ratings. The ICR rated the project's outcome as satisfactory, institutional development as substantial, sustainability as likely, and Bank and borrower performance as satisfactory. However, the rating in the text of the ICR for project outcome is marginally satisfactory. Based on the information presented in the ICR, the OED evaluation summary (ES) disagreed with four ratings, and rated outcome as unsatisfactory, institutional development as modest, sustainability as uncertain, Bank performance as unsatisfactory. The ES recommended the project be audited,

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1. The changes included putting in place a coherent tax system, a two-tier banking system, and legislative and institutional environment for the development of the private sector (e.g., company law, bankruptcy law, law on accounting, competition law, etc.).

2. This change in focus shifted the implementation responsibility from the Ministry of Agriculture (MOA) to the Ministry of Industry and Trade (MIT), since retail trade was the purview of MIT.

raising two sets of issues: poor quality at entry, and the rationale for not closing the project earlier when disbursement problems were already evident by the midterm review.

The ICR covers the project's implementation experience and the factors affecting project outcome. However, its treatment of some of the issues raises more questions than provides answers to. In some instances, either the text of the ICR is inconsistent with the data contained in its annexes or the project files, or it does not adequately explain its interpretation of the data. More importantly, it does not provide sufficient context in which to assess the project's performance or its contributions. Instead of delving into all the details, this report will focus on the main issues and those details where the ICR is inconsistent or which are relevant to assessing the project's performance and outcomes.

## 2. Project Objectives

The overall objective of the project was to strengthen the operational and pricing efficiency of product markets and, thereby, to improve the business environment so that producers and trading companies would be able to adjust efficiently to changing market conditions. Within this broad framework, the specific objectives of the project were to:

- Reduce costs in the overall logistics system (i.e, packaging, transport, handling, storage and management of general consumer goods) and to pass, in part, these savings to consumers in the form of lower costs
- Add value to products through improved services
- Enhance the competitiveness of Hungarian products in domestic and foreign markets
- Help commercial banks to add financing investments in this new field to their portfolios.

**Components.** The project sought to achieve these objectives through two components:

- *Financial assistance* to a broad range of investors, for working capital and medium- and long-term investments, to undertake activities to strengthen their logistics-related operations. The project provided a line of credit (LOC) for US$99.2 million, through the National Bank of Hungary (NBH), the borrower, to qualified commercial banks for onlending to eligible entities for the establishment of new, or for enhancing the efficiency of, existing operations involving marketing, trade and distribution of consumer products.

- *Technical assistance* to support the implementation of actions to enhance the operational efficiency of product markets and their enabling environment, including for investing in activities promoted by the project. These actions were part of the Public and Private Sector Action Plans (PUSAP and PRSAP, respectively) developed during project preparation with the participation of the main concerned public and private sector representative agencies. It was anticipated that the government would seek grant funds for TA program. However, in the event that sufficient resources could not be mobilized, the project provided for US$0.8 million to support the TA. The actions included (i) training and advisory services in, and the promotion of logistics management through a new Logistics Promotion Center (LPC); (ii) training for the staff of participating banks in lending for logistics-related investments through the International Training Center for Bankers (ITCB); (iii) improvement in the market information systems (MIS); (iv) establishing and operationalizing standards and grades for products; (v) strengthening the food safety and quality control system; and (vi) arrangements for the supervision of commodity exchanges. The first two were part of the PRSAP, and the others were part of the PUSAP.

**Evaluation of project objectives and design.** At appraisal, the project's objectives were high priorities for the country and for the Bank's country assistance strategy (CAS). The CAS supported the government's objective of radical transformation to a predominantly private, market economy. It sought to deepen the implementation of structural reforms and promote efficient development of the economy. The project's objectives of strengthening the enabling environment for product market development were highly relevant to the country's needs at the time, and were fully consistent with the borrower's development strategy and the Bank's CAS. As the Staff Appraisal Report (SAR) notes, the marketing subsector was saddled with significant inefficiencies, a legacy of the previous central planning system. These inefficiencies needed to be addressed urgently for Hungary to compete with other market economies and to allow the rapidly emerging private sector businesses to respond to correct market signals.

On the project's quality at entry, the ES raised two issues questioning the need for the project's LOC. One related to the rationale for the project at a time when there were nine other IBRD-financed LOCs under implementation, many of which were experiencing slow disbursements. In this context, the SAR and ICR note that PMDP was a unique project, highlighting the importance of logistics management. Commercial bank lending for logistics related activities was limited, and an important rationale for the LOC was to promote investments in logistics management. It was to play a mutually complementary role with the project's TA in improving the efficiency of product markets. Targeting a field not covered by other projects, the intent was also to complement the other LOCs, which were supporting investments in productive activities.

A review of the problem of slow disbursements by the region (memo dated October 20, 1992), identified the ongoing recession, high inflation, and uncertainties fueled by the structural adjustment program as the main reasons. The review assumed that as the economy stabilized and started to grow again, the disbursements would pick up. There were also differences across sectors and in the design of individual projects which explained some of the disbursement problems. LOCs in the agricultural sector and those targeted at small and medium enterprises (SMEs) were disbursing ahead of schedule.[3] The prognosis for PMDP was also positive.

The poor performers were the older LOCs which had been pre-appraised by IBRD and were targeted for specific sub-projects, and primarily at state enterprises, reflecting the economic structure of their times. PMDP, on the other hand, was more broadly targeted, both in terms of beneficiaries and range of activities, than previous LOCs.[4] The relatively newer lines were also shifting to a model of relying on participating banks (PBs) for credit promotion and subproject selection. This trend targeted, and coincided with the PB's growing interest in, the emerging private sector SMEs. To induce PBs to take more initiative and play a proactive role in seeking new businesses and clients, PBs were asked to bid for allocations from the PMDP LOC, and to pay a commitment fee on their allocations. Thus, the project design was consistent with emerging lessons from other LOC operations in Hungary, reflecting the successful experience with the two-tier banking system and the very satisfactory performance of NBH in project implementation.

3. The Integrated Agriculture Export Project (Loan 3229) was fully committed, well ahead of schedule, and the demand for the small scale component of the Third Industrial Restructuring Project (Loan 3020) exceeded its allocation.

4. See SAR para 3.04. It was also noted in the borrower's comments at the time of the 1997 CPPR, and reiterated during the audit mission, that the scope of PMDP was much broader than previous IBRD LOCs.

Despite having a broader scope than other LOCs, the issue of sub-sectoral targeting nevertheless remains. In general, it is a difficult issue to address. On the one hand, the question remains as to why the existing LOCs could not have been generalized to include PMDP activities. On the other hand, the project specifically sought to have a demonstration effect, by introducing the PBs to lending for trade and marketing activities. In this context, it is worth noting that the IBRD review of the existing LOCs recommended restructuring the LOCs with longer time to closing to make them more flexible, and closing or canceling the older ones. For the long-run, it recommended a more complete review of the IBRD assistance program and the role of public support for private initiatives. The NBH agreed to opening up the eligibility conditions of one loan (the Third Industrial Restructuring Loan) but wanted to defer the decision on PMDP until after initial experience with the project (PMDP was not effective at the time).[5] The sub-sectoral targeting nevertheless proved to be a design weakness, as evident by the fact that during implementation, the scope of eligible activities was repeatedly broadened in efforts to improve disbursements.[6]

The second issue was the expected additionality of PMDP funds in the light of significant private capital inflows into Hungary. This issue arose primarily because of the lack of clarity in the ICR on the chronology of developments in Hungary at the time of appraisal. The capital flows had just started in 1991, but their magnitude or continuity was not certain. The access of larger companies to foreign capital markets was improving, but for most emerging private businesses, particularly the SMEs, this was not the case. At the time, IBRD lines were still the main source of stable medium- and long-term finance and were in high demand by the burgeoning private sector, mostly SMEs. Despite the rapid changes, foreign lenders were still reluctant and were charging high risk premiums. This also made IBRD funds relatively more attractive. More importantly, because of high inflation and uncertainty, there was a dearth of long-term forint resources. Under the circumstances, securing sufficient resources to ensure progress in the economic transition was a high priority for NBH. Hence, NBH tried to "lock in" as many long term resources as it could. Further, since the LOC was demand-driven, with private sector PBs bidding for and willing to pay the commitment fees on IBRD funds, NBH had no reason to oppose the loan.

In the context of the relevance of the project, the ICR appears to downplay the main contribution of the project, it's technical assistance component, and hence its eventual institutional development impact. A major share of the project's technical assistance contribution was in fact already made during the project's preparation, even before it entered the implementation phase. The SAR summarizes outcome of the two year long project preparation work, in full collaboration and participation of the various public and private sector entities. It presents a comprehensive analysis of the state of the enabling environment, identifies the key issues, and prioritizes specific actions needed to improve the legal, regulatory and operational framework for a more efficient functioning of the product markets.[7] It also includes detailed terms of reference to carry out the identified technical assistance components. The key actions were formulated in the form of a matrix, identifying the roles and responsibilities of various public and private sector entities, and the timeframe for achieving the targeted actions. These plans were dubbed the PUSAP and PRSAP. The project's technical assistance program was designed to support the

5. There were two other ongoing loans at the time on which the discussion was deferred pending further consultations as any restructuring would have required more modifications than just generalizing the LOC.

6. However, the reasons for slow disbursements were several. As discussed later, the relaxing of restrictions on eligible investments did not lead to any substantial increase in disbursements.

7. Project preparation was based on a comprehensive set of 8 studies, conducted specifically for the design of the project identify the issues and actions needed to improve market efficiency and the enabling environment for product markets.

implementation of these action plans. The audit considers design of the TA component and its preparation process a significant element of the project's quality at entry.[8]

Overall, the audit considers the project to have been justified and its design at entry to have been satisfactory, despite the questionable element of targeting in the LOC. The project's main objective of improving the operational and pricing efficiency of product marketing was relevant at appraisal, and continues to be as Hungary gets ready for accession to the EU.

# 3. Implementation

***Financial Assistance Component.*** The implementation of this component was affected by a number of factors, many of which were beyond the project's control. At the macro-level, the broader economic trends through the mid-1990s provide interesting insight into the patterns of project disbursements.[9] The disbursement of the LOC started out at a brisk pace, although it was below appraisal targets throughout the project's life.[10] Considering the economic conditions at the time – significant uncertainties in the business climate, a recession (with a negative real GDP growth rate in 1993), high inflation (and consequently high nominal interest rates[11]), a lack of "bankable" projects (because of lack of creditworthiness of new private borrowers) and collapse of former assured (CMEA) markets – the lag in disbursements was not a surprise, nor was it a characteristic particular to either the PMDP or to IBRD LOCs.

Despite these adverse conditions, however, disbursements increased from US$6 million (66% of the target) in 1993 to US$20 million (71% of target) in 1994. This was also significant as it occurred at a time when structural reforms and privatization were generally perceived to have stalled, the country was running a high current account deficit, and the decline in Hungary's creditworthiness resulted in a significant slowdown in the flows of foreign direct investment. Against this background, the reasonably robust increase in disbursements in the early years suggests that PMDP provided much-needed funds to support investments, particularly for SMEs.

Faced with a potential balance of payments crisis, in 1995 the government simultaneously implemented a stabilization package and accelerated the structural reforms. These included major enterprise and bank reforms, including a restructuring and privatization of all major banks. This added to an already high inflation rate and resulted in a decline in real investments and consumption, but set the country on a path to stabilization. Foreign direct investment jumped, and the banking sector was transformed, with many Hungarian banks forming joint ventures with foreign banks. PMDP disbursements, while increasing again in 1995 by a sizeable amount (US$15 million, the same as in 1994), started to slow in 1996, coming to a virtual halt in 1997.

Among the factors affecting implementation at the micro level, an important one was the issue of an uneven playing field. Committed to charging market based interest rates, which were high

8. In addition to not discussing this aspect of quality at entry, the ICR also rates the World Bank's performance during the preparation and appraisal stages as only marginally satisfactory.

9. See World Bank (1999): *Hungary – On the Road to the European Union*, a World Bank Country Study, for more details.

10. Assessing performance against the achievement of targets, however, is a bit tricky since the targets were based on perceived demand by the PBs in a volatile market environment, which may well have been too optimistic. In this respect, project appraisal could have been more diligent in identifying demand more accurately.

11. PMDP funds were to be lent at positive real interest rates, and no subsidies were permitted in conjunction with the project sub-loans.

through most of the projects life because of high inflation and the requirement to maintain positive real interest rates, PMDP faced tough competition from subsidized credit lines. These credit lines were introduced after PMDP became effective and most were financed by bilateral and other multilateral sources, and some by the government. These other credit lines were also more flexible than PMDP since they did not place any restrictions on the end-use of the funds (specifically the purchase of used assets and real estate), another requirement of IBRD policy. Other factors included the scope of activities eligible for financing, application or reporting procedures perceived as being overly cumbersome, and complicated procurement guidelines. While some issues, such as widening the scope of activities eligible for funding, were addressed by Bank supervision mission by amending the loan agreement, they did not have any significant impact on disbursements. The main problems, however, could not be addressed because of IBRD policies (on interest subsidies and the purchase of used assets, real estate, etc.). The combination of these factors affected implementation by reducing the demand for PMDP funds.

A total of 641 loans were made under the project, all to private and none to state enterprises. The average sub-loan size was much smaller than anticipated (US$70,000 against US$500,000). The majority of loans were for produce marketing activities (88%), and rest for other activities, including agro-processing, storage, transport, etc. While the composition of the sub-portfolio was different than may have been expected, with significantly greater allocation for wholesale and retail trading, the activities financed were nonetheless among those considered as high priority by the SAR.

The ICR raises concerns about the high level of working capital financing twice. In the first instance it notes that overall about two-thirds of the loans, in terms of amount, were for working capital (page 7). This statement, however, is inconsistent with the ICR's own annexed table (on page 33), which shows that investment financing accounted for 58.4% of the total disbursements by the PBs, and working capital for 41.6%. The figures in the table, reported by the PBs, are consistent with the pre-appraisal mission's anticipation that about 35% of the total loan amount would be allocated for financing free-standing working capital.[12]

The second instance the ICR raises concern is in its discussion of implementation issues, again with the concentration in working capital finance (page 8). It notes that over 80% of the disbursements were for retail and wholesale trade, presumably all for working capital. However, it should be noted that the SAR specifically identifies the need for medium- and long-term financing for permanent working capital, for improving the efficiency in inventory management, and for marketing efficiency of final consumer goods, both at wholesale and retail trading levels (e.g., automation, bar coding and packaging).

With respect to the quality of the sub-portfolio, the information contained in the ICR on repayment performance led the ES to question the project's performance. The ICR concludes that "overall, the repayment performance of around 80% under this credit operations falls somewhat below some other credit line operations...".[13] According to an analysis of the sub-portfolio, which

12. Pre-appraisal mission Back to Office report, dated November 7, 1991.

13. The ICR notes that the IBRD supervision mission of June 1996, identified the deteriorating repayment performance, with some PBs experiencing arrears or defaults in 20-25% of their loans (by number). According to the NBH (letter dated September 24, 1996, in response to the supervision mission's Aide Memoire), however, only 3 of the 6 PBs were experiencing problems. Overall, 12.6% of the total sub-loans were in arrears, mostly in the form of delayed interest payments. Individually, one bank had 28% of its loans suffering from arrears (4 of 14), the second had 23% (41 of 173) and the third 6% (15 of 231) of its loans in arrears. The total amount in arrears is not known. The supervising task manager informed the audit mission that the purpose of noting the deteriorating performance was to bring the issue to the attention of NBH and PBs. At the time, the sub-loans had just started to become due and the initial statistics were not satisfactory. These concerns were acted upon by NBH and the PBs with closer monitoring of the sub-portfolios.

was also available to the ICR mission and is attached as Annex B to this PAR, it is not clear what percentage of the sub-portfolio was overdue. The total *outstanding* sub-loan amount (as of August 31, 1998) was about US$8.4 million (which is 20% of the total amount of loans disbursed under PMDP, US$40.6 million). Of this, US$0.23 million of the principal amount had "matured" and US$0.07 million was overdue interest.[14] How much of the outstanding portfolio is in arrears cannot be established from the available data.

Another table in the Aide Memoire of the ICR mission, attached to the ICR, provide some more information. At the time of closing, 4 PBs had outstanding sub-loans. Of these, the largest, with 44% of its total disbursements outstanding, reported no overdues. Two other PBs had less than 5% of their total disbursements still outstanding. Even if it is assumed that the entire outstanding amount will eventually be lost, the loan-loss ratio would still be acceptable. The fourth PB had about 29% of its disbursements outstanding. During a visit by the audit mission, this PB indicated that the proportion of the current sub-portfolio categorized as bad or doubtful was 1.4%.

Thus, even if the sub-portfolio was showing significant arrears at the time of project closing, as reported by the ICR, the arrears appear to have been reduced. The NBH also confirmed that the overall sub-portfolio performance had been satisfactory. The early arrears were actively pursued, including through legal action, to improve the repayment performance of the sub-portfolio.

The second major issue for this audit, as identified by the ES, was why the project continued to completion, when disbursement problems came to light by before the midterm review (May 1997). Initially, NBH expected the disbursements to pick up as the economy came out of recession. The Bank's supervision missions brought the issue to the notice of the project steering committee as early as 1995, and recommended steps to speed up the disbursements. These included widening the scope of eligible activities that were consistent with project objectives, including covering new sectors such as telecommunications and trade of bulding materials and pharamceuticals (although still within IBRD policy guidelines), packaging of PMDP sub-loans with financing from other sources, and proactive actions by the steering committee to publicize and popularize the PMDP LOC. These efforts, however, did not lead to any significant increase in disbursements.

The Ministries of Industry and Agriculture were also encouraged to develop proposals for new regional distribution and wholesale marketing centers. However, these initiatives required equity participation from regional and local governments, which were not in a position to mobilize adequate resources. Finally, by the time the concepts were formalized, it was too late in the project cycle to develop detailed plans and execute them by the project closing date. Faced with continuing slow disbursements, the supervision missions and NBH encouraged the PBs to conduct fresh surveys to determine how much of their allocations they could realistically utilize. The PBs were also encouraged them to cancel their allocations based on their revised estimates of demand.

One complication was the lack of a clear cut provision to cancel unused funds. In principle, NBH felt that the decision to cancel their allocations was up to the PBs as they had bid for them based on their own assessment of the demand for funds, and were paying the commitment fees. Procedurally, with a legal subsidiary financial agreement with the PBs, NBH felt it had little leverage other than to request voluntary cancellations. IBRD staff similarly felt they could not formally pursue loan cancellation. Nevertheless, NBH did pursue the issue and many of the PBs

14. The largest amounts of matured principal and interest overdue at closing were for Kereskedelmi Bank Rt., at US$0.17 million and US$0.06 million, respectively. The total subloans disbursed were for US$19.3 million, of which US$5.7 was outstanding as of August 31, 1998.

did cancel part of their allocations; some had already pre-paid IBRD funds. Others decided to keep at least some of the allocations until the formal closing date. Starting in May 1997, a total of four cancellations were effected, for a total of US$59.4 million.[15]

The PBs, for their part, had little incentive to return their allocations. They valued the security provided by the relatively cheap access to long-term resources, at a time when domestic resources were relatively expensive.[16] [17] Association with the IBRD and access to its LOC was also perceived by some PBs as adding to their creditworthiness. The value attached to the access to LOC, and perceived potential demand for the funds by the PBs, is evident by the fact that even as late at 1998, two new PBs bid for PMDP funds.

***Technical Assistance Component.*** The overall implementation of the TA program was satisfactory. While no PMDP funds were used for the TA, the project has contributed significantly to the improved functioning of product markets. As noted earlier, it helped lay the foundation for significant changes in the policy, regulatory and institutional framework which have had significant indirect benefits. The changes specific to the project's objectives were incorporated as actions for various public and private sector entities in the PUSAPs and PRSAPs. The project provided a timeline and a framework for coordinating and ensuring the implementation of the different actions, overseen by a multi-agency steering committee.

After some delays, Hungary was able to mobilize grant funding from the Dutch government to implement most of the sub-components of the TA program. The stand-by PMDP funds for the program were eventually cancelled. Under the agreement reached, IBRD was responsible for overall project supervision; the Dutch government would take the project components as designed and provide the financing to carry out the TA as per the terms of reference as contained in the project documents. The responsibility for the implementation of the project activities was with the project steering committee.

The establishment of LPC was central to the project concept. To ensure the project implementation got off on schedule, the government provided a grant for the establishment and upkeep of the LPC. Despite being a very small unit, working in collaboration with professional associations, universities and colleges, LPC has been highly successful in its mission, that is, to increase the awareness among business managers of the importance of logistics management for improved efficiency, cost reduction and customer services. It offers a number of courses, including a degree course, on logistics, and organizes conferences, seminars, and study tours for a wide range of logistics related activities. It has developed a recognized library on logistics, including some new Hungarian publications that it has helped produce. Logistics was unknown in Hungary prior to the project, but is now recognized as a professional field. This has no doubt contributed towards the competitiveness of Hungarian products in both domestic and foreign markets, including by indirectly promoting investment in critical downstream marketing activities. Overall, the objectives of this sub-component have been fully met. The issue of its sustainability is discussed below.

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15. The four cancellations were: US$25 million in May 1997, US$11.1 million in March 1998, US$9.2 million in May 1998, and US$14.1 million at closing, June 1998.

16. The commitment fees were 0.25 percent of the allocated amount.

17. The funds were lent by NBH to PBs only in local currency. PBs did not have the option of getting funds in foreign exchange, nor did they apparently want it. In some LOCs, financed from other sources, the PBs and sub-borrowers had access to both forint and foreign exchange loans, but the demand was mostly for forint resources according to NBH.

Among the other sub-components, the objectives of strengthening the food quality and safety control system have also been met, as have the establishment of international and national product standards. The relevant regulations have been enacted and institutions established, and Hungary is well placed in its quest for EU accession. The objective related to the Budapest commodity exchange (BCE), to establish the legal framework for, and supervision of BCE, was fully accomplished with the enactment of the Commodity Exchange Act in 1994, and the subsequent delegation of its supervision to the inspectorate responsible for the Budapest stock exchange. Thus, while the supervisory and regulatory framework for BCE is now firmly in place, the project had little role in its implementation beyond identifying it as a high-priority action.

Two sub-components of the TA program were not fully implemented. The MIS sub-component anticipated implementation in two phases. Phase one was to focus on developing a strategy and an implementation plan for improving the MIS. This was successfully undertaken with the help of a Dutch grant. Phase two was to implement the strategy, but progress has been stalled for lack of funding. The budgetary pressures on MOA have also had an effect on MIS operations, with reduced operating budgets stalling the much needed upgrading of computers and equipment. While the collection and dissemination of price information has improved, the ability to forecast demand and supply conditions remain weak.

The sub-component on the training of PB staff in lending for logistics-related activities was not successful. In addition to its normal courses on project appraisal and management, ITCB was to design and administer the appropriate training courses. As part of their regular training program, PBs send their staff to ITCB for courses. But as the courses are paid for by the PBs, the design of the training program is essentially demand driven. At the start of PMDP implementation, ITCB offered courses specifically targeted at logistics-related activities, but found interest to be lacking. According to ITCB, this reflected in part the nature of the banking business in the early 1990s, when project management was not considered important.

With changes in the banking system since 1995, and a consequent increase in the importance of project management, interest in courses on project appraisal and evaluation has grown. ITCB currently does not offer any specific courses dealing with investment in marketing, distribution or logistics, but it does foresee these topics becoming relatively more important in the future. For specialized courses, ITCB noted that it would be willing to accommodate the demand by PBs. Until then, the general concepts and procedures are already covered as part of the general courses on project management. It is noteworthy, however, that some of the problems with PB financing noted in the SAR continue today (such as the overvaluation of collateral offered by SMEs) while other problems seem to have been overcome (financing of marketing and distribution activities such as inventory financing, storage, transport, etc.).

# 4. Principal Ratings

There was a significant difference between the ICR and the ES on all except one (borrower performance) of the principal project ratings. As discussed earlier, however, the information and data presented in the ICR were not incomplete or inconsistently presented. The ICR covered the key issues, but the implementation experience and factors affecting the project were presented without sufficient explanation of the context or the chronological developments in Hungary. As a result, the ICR raised a number of unresolved issues, leading the ES to downgrade most of the ratings. With the benefit of additional information, this PAR is able to address the issues that the ES was concerned with, and arrives at different conclusions.

The two key issues for this audit were its quality at entry and the rationale for continuing with the project when problems began to surface well before the original closing date. These issues have been discussed in sections 2 and 3. Briefly, the audit considers the overall quality at entry to have been satisfactory. The primary objective of the project, improving the pricing and operational efficiency of product markets, was relevant at appraisal. Project design was also highly satisfactory with respect to the TA component, but the targeting of the LOC is questionable. How significantly this design element affected the efficacy.of the LOC is difficult to answer since a number of other factors were simultaneously affecting sub-loan disbursement. Over time, as the circumstances changed, the project's LOC was not needed. In response to the new operating environment, actions were taken to cancel a significant part of the loan.

***Outcome:*** Product markets are fairly well developed in Hungary and are increasingly being diversified. While no direct evidence is available on the reduction in the cost of logistics, indirect evidence suggests significant improvement in the marketing and operational efficiencies in the product markets. Audit mission interviews with some local businesses, including supermarket managers, suggested that marketing efficiency (in terms of quality of services, transportation time, product packaging and differentiation, etc.) has significantly improved over the past 6-8 years. Estimating cost changes is not easy as reduced costs through pure efficiency gains are mixed with improved quality (better transport facilities and higher element of processing).

At the macro level, Hungary has significantly increased its exports to the EU. While the exports to Central and Eastern European Countries (CEEC) have also gone up, the share of EU in exports has increased significantly (from 31 to 42%) while the share of CEEC has declined from 16 tp 11%. These trends indicate that Hungarian products are more competitive than before. For example, Hungarian agricultural products are able to compete with EU products even though the producer subsidy element in Hungary is significantly lower than in the EU. Contrary to expectations, Hungary has maintained the absolute levels of agricultural exports. The increased competitiveness of Hungarian products is partly attributed to reduced transport and information costs, and to changed institutional environment and a favorable climate for foreign investment![18]

It is evident that substantial progress has been made towards meeting the broad objectives of PMDP of improved operational and pricing efficiency of product markets. Although, by no means can PMDP be credited for all of the successes, it has contributed to the development of Hungarian product markets, and significantly so according to virtually all of the officials of various key implementing agencies met during the audit mission. The TA component, and to a smaller extent the LOC, is widely believed to have played a strong "catalytic" effect in promoting institutional development and downstream investments in logistics-related activities.

From Hungary's point of view, the success of the project lies not only in terms of its physical impact, but also from its contribution towards institutional development, which in turn supported economic development in line with the country's priorities. As such, the members of the steering committee and other officials met during the audit mission, consider the project to have been successful in meetings its objectives. The audit agrees with this assessment. The major contribution of the project has been more indirect than direct, and more from its TA program, including notably project preparation, than from the impact of its LOC.

The utilization of the LOC, and consequently it's impact, have been substantially less than expected. However, it should be noted that it did provide, albeit less than anticipated, much-needed longer term capital to new, mostly small and medium sized firms for investment in

18. World Bank Country Case Study: Hungary: On the Road to European Union, 1999.

marketing activities. The investments financed were profitable and economically viable, which is also testified by the satisfactory repayment performance of the sub-loan portfolio.

The fact that the loan did not fully disburse, however, does not detract from the project's major achievements. Further, the failure to disburse is not by itself necessarily a negative consequence, especially for a demand-driven project in risky market environment. While on the one hand it reflects an overestimation of demand, on the other it shows that PBs also exercised prudent judgment in not disbursing indiscriminately, which could have added to subsequent portfolio problems. The project activities were overtaken by developments beyond its control, and these were also in fully consistent with the project's objectives of improved functioning of markets. The transition to a market economy has gone faster than anticipated and Hungary is now in a position where it does not anticipate the need for similar projects in the future.

The project major objectives have been substantially met. The project's contribution to improvements in the legal, regulatory and institutional framework for product market operations, and especially to the increased competitiveness of Hungarian products in domestic and international markets, have been substantial. The project's direct physical impact has been much less than anticipated. And perhaps the loan cancellations could have started earlier and the project closed sooner, but the continuation of the project does not appear to have any major adverse impacts, and by itself is not sufficient to outweigh the contribution of the project's TA component. Overall, the audit rates project outcome as **satisfactory**.

***Institutional Development Impact:*** The PMDP had only modest impact on the capacity of PBs to handle sub-projects of logistics-related activities, although most PBs have are now financing marketing and distribution related investments. The impact on the forecasting ability of the market information system has also been limited. However, the project's impact has been high in its contribution to the development of the policy and regulatory framework for improving the operational efficiency of product markets. The major achievements include the enactment of laws on product standardization, national accreditation, and commodities exchange and exchange transactions, and improvements in food safety and quality control systems and the harmonization of food regulations with the EU and FAO/WHO Codex Alimentarious provisions. Another suggestion of the project was to establish product councils, which has been done.[19] Overall, the project has contributed towards improving the "rules of the game," and as such institutional development impact of the project is rated as **substantial**.

***Sustainability:*** The ICR noted that with the exception of LPC and MIS, the sustainability of all other TA sub-components is likely as the necessary institutional, policy and regulatory changes are firmly in place. The importance of logistics management, however, is by now well established, and hence the impact that LPC has had so far is also likely to be sustained. The private sector investments financed from the LOC are financially viable, and the sub-portfolio performance is satisfactory implying no negative financial impact on PBs. Commercial banks have also moved into financing logistics-related activities as part of their regular portfolio.

At the time the ICR was prepared, the sustainability of MIS and LPC was questionable. In the case of MIS, the funding for phase two has yet to be mobilized. However, MIS are of critical importance to Hungary, particularly with EU accession. Because of its essentially public goods nature, MIS should be funded by the government, but with limited budgets, MOA has not yet

19. These councils were designed to integrate and coordinate marketing channels and include representatives of all stakeholders, including the private sector. They have played a significant role in the exchange of information and views between the government and various stakeholders.

committed to adequate funding – even for upgrading and maintenance costs – making sustainability uncertain.

At appraisal, it was anticipated that LPC would become financially self-sustaining in a period of 4-5 years. At the current time, LPC is not truly self-sustaining, but it can continue operations so long as it retains the MIT start up investment fund and continues to use the interest income to supplement the revenues from its activities. It is charging for the courses it offers, which are currently fully subscribed, but the fees from all its activities are not sufficient to cover all costs. It continues to seek alternative sources of revenues. On the issue of the future of LPC, MIT informed the audit mission that it wants the LPC to continue operations and to provide professional advisory services to the Ministry. It does not anticipate privatization any time soon, but the center, either in its present or a modified organizational form, is likely to continue to exist.

On balance, project outcomes are **likely** to be sustained.

***Bank (IBRD) performance:*** The borrower considers IBRD performance to have been satisfactory, and several officials met during the audit mission, were highly appreciative of IBRD's role in the project. IBRD performance during project identification and preparation phases was highly satisfactory, for several reasons as noted earlier. Project appraisal could have been more rigorous in determining the potential demand for PMDP loans. The project's design could have been improved by including provisions for loan cancellations in case of slow disbursements. Project design could also have streamlined procurement guidelines and reporting procedures in consultation with the private sector and PBs to suit the local circumstances. Overall, however, the project design was vindicated in the initial years when project disbursements increased at the same time that foreign capital flows were slowing, albeit for a brief period, and general economic conditions were not favorable for project implementation. The quality at entry is hence rated as satisfactory.

The project's LOC became largely redundant in the later years, especially after 1995, as alternative sources of funds became available. As the events unfolded, the project supervision could have been more proactive in pursuing earlier closure. Part of the problem was infrequent and inadequate supervision, with short and understaffed missions covering a number of projects for lack of adequate resources. The supervision missions were responsive to emerging issues, but the project files do not indicate any serious attempts as follow up to actions noted by previous missions. The mid-term review was delayed, because of the internal reorganization in the World Bank. With timely supervision and mid-term review, more definitive decisions on project cancellations could have been made earlier. While project supervision was less than optimal, for reasons discussed earlier, the delays do not appear to have had any major adverse impact on project outcomes. PBs were also willing to willing to hold on to their allocations.

On balance, IBRD's positive role in developing and supporting the TA program, the quality of it's contribution in project preparation, and the flexibility shown during supervision to address disbursement problems by modifying the loan agreement, were more significant than the shortcomings in the project supervision and the some design issues. Overall, the audit rates IBRD performance as **satisfactory**.

***Borrower performance:*** The TA components, especially the enactment of the legal and regulatory changes, were undertaken and completed in a reasonably timely manner. The government ensured timely project startup by providing funds for the LPC establishment. For a small organizational unit, the LPC has proactively formed partnerships with professional and academic institutions and has been highly successful in its mission. The project steering committee met on a regular basis and was proactive in identifying problems and promoting project activities. Among the main agencies involved, the MOA could have shown a greater sense of ownership of the MIS program through better budgetary support. The ITCB could also have been more proactive in promoting the courses on the financing and management of logistics related activities. In general, the borrower – NBH – and the sub-borrowers, the associated agencies responsible for project sub-component implementation, performed fully satisfactorily. Borrower participation in project preparation was fully **satisfactory**.

# 5. Findings and Lessons

This audit has three main findings, each of which yields a lesson for future operations:

***Project's contribution***: The first relates to the project's contribution considering that many of the TA activities were strongly driven by the desire of Hungary for an early accession to the EU.

One member of the steering committee interviewed during the audit mission summarized the issue well: institutional development was needed, irrespective of the project. Hence, if the project had not been there, these changes would have been undertaken, especially with the decision to join the EU. The contribution of the project, considered to be significant by the steering committee and various agencies, was in "focusing the light" on critical institutional, policy and regulatory aspects that were needed to improve the efficiency of Hungarian markets and to make Hungarian products more competitive. The project helped formulate the PUSAPs and the PRSAPs, identifying specific actions required and detailing a roadmap to achieving them. More importantly, the project defined steps to be implemented on a clear timetable.

These were critical but intangible and unquantifiable contributions of the project's TA (especially during project preparation). Thus, while the LOC was important, the overall impact of the project went well beyond what was, or could have been achieved, by the physical impact of the LOC alone. The project is also widely believed to have played an important catalytic role in promoting new private sector investments in logistics-related activities. Overall, the important role of the project, and IBRD, in providing technical and physical support for national priorities, at a time when it was much needed, was repeatedly noted by the various agency officials met during the audit mission.[20]

> *Lesson*: Good technical assistance, especially during project preparation, can significantly contribute to the development effectiveness of Bank operations. PMDP's contribution started even before the physical implementation began. A prerequisite to this, a lesson now familiar, is the need for substantive government ownership, which is a critical factor in addressing policy and institutional issues. Solid project preparation can also act as a catalyst to mobilize other (non-project) development resources, leveraging the impact beyond what individual projects are likely to be able to deliver.

***End-use restrictions***: A second finding, of importance to the design of similar projects in transition economies, is the effect of restrictions on the end-use of funds on project implementation and its development impact. As a matter of policy, IBRD funds cannot be used for financing used assets (real estate, buildings or equipment). In Hungary, this restriction was in direct contradiction to one of the borrower's and the World Bank's primary goals – privatization

20. It is important to add, however, that this PAR is not suggesting that IBRD was solely responsible for all of the success in Hungary's marketing and trade sector. The appropriate way of looking at the project's contribution is the support that IBRD provided to Hungary as a development partner in working towards it's national objectives.

of economic enterprises. Privatization in Hungary mainly involved the divestiture of state enterprises, but with restrictions on financing of used assets and real estate, project funds cannot be used for this purpose. This was the problem cited most by the officials of NBH and PBs as affecting disbursements. The issue is complicated, given the valid rationale for the policy restrictions in some circumstances, and is one that needs to be reconsidered, with the benefit of careful further study, in the context of transition (and other similarly placed) economies.

> *Lesson*: The Bank needs to refine its policies to make them contextually relevant. Alternatively, it needs to develop mechanisms that can reconcile its major objectives, in this case privatization, with policies, such as restrictions on financing used assets or real estate. While the latter have no doubt been adopted for good reasons, there are cases where rethinking of rigid and blanket guidelines is warranted.

***Competitiveness***: The third major finding relates conditions and procedures characteristic of many World Bank projects which reduce their competitiveness in financing private sector investments. The Bank's reporting requirements, disbursement categories and procurement guidelines are perceived by most private businesses (on-lending banks and sub-borrowers) to be too cumbersome and costly. For example, PBs routinely prepare sub-project appraisal documents, but for World Bank LOCs these need to be translated into English and require details which add to the transaction costs. Also, most established private sector companies have their own procurement guidelines and are either unwilling or find it very cumbersome to also follow the Bank's guidelines. Credit lines from other sources, bilateral or multilateral, do not have similar requirements. These issues, along with no restrictions on the end-use of credit and below market interest rates, make these credit lines more attractive than the World Bank's credit line.

> *Lesson*: The Bank needs to properly analyze the expected benefits from the conditions imposed on projects as regards complex eligibility criteria, reporting requirements and procurement guidelines and their impact on on-lending institutions and borrowers' transactions cost. Each project is implemented in a different situation and the conditions need to be properly assessed to ensure smooth implementation.

# Basic Data Sheets

## Product Market Development Project (Loan 3509-HG)

### Key Project Data (amounts in US$ million)

***PROJECT COSTS***

| *Item* | *Appraisal Estimate (US$M)* | | | *Actual (US$M)* | | |
|---|---|---|---|---|---|---|
| | Local Costs | Foreign Costs | Total | Local Costs | Foreign Costs | Total |
| 1. Credit | 151.0 | 99.2 | 250.2 | - | - | 86.2 |
| 2. TA | 1.2 | 3.1 | 4.3 | - | - | 2.1 |
| Total | 152.2 | 102.3 | 254.5 | - | - | 88.3 |

### Cumulative Estimated and Actual Disbursements (in US$ thousands)

| | *FY93* | *FY94* | *FY95* | *FY96* | *FY97* | *FY98* |
|---|---|---|---|---|---|---|
| Appraisal Estimate | 9.0 | 29.00 | 51.00 | 71.00 | 90.00 | 100.00 |
| Actual | 5.99 | 20.33 | 35.11 | 42.09 | 42.53% | 43.61% |
| Actual as % of Estimate | 66.56% | 71.70% | 64.18% | 34.75% | 2.31% | 10.80% |
| Date of Final Disbursement 03/13/98 | | | | | | |

### Project Timetable

| *Steps in Project Cycle* | *Actual Date* |
|---|---|
| Identification (Executive Project Summary) | 06/18/90 |
| Preparation | 10/01/90 |
| Appraisal | 10/11/90 |
| Negotiations | 04/28/92 |
| Board Presentation | 07/14/92 |
| Loan Signature | 08/24/92 |
| Effectiveness | 11/18/92 |
| Midterm Review (if applicable) | 05/04/97 |
| Loan Closing | 12/31/98 |
| Project Completion | 06/30/98 |

### Staff Inputs (staff weeks)

| Stage of Project Cycle | Actual | |
|---|---|---|
| | *Weeks* | *US$* |
| Preparation to Appraisal | 78.6 | 181.0 |
| Appraisal | 23.8 | 64.8 |
| Negotiations through Board Approval | 12.9 | 33.5 |
| Supervision | 42.9 | 119.8 |
| Completion | 8.2 | 11.1 |
| **Total** | **166.4** | **410.2** |

### Bank Resources - Mission Data

| *Stage of Project Cycle* | *Month/ Year* | *Number of Persons* | *Days in Field* | *Staff Specialties*[1] | *Performance Rating* | | |
|---|---|---|---|---|---|---|---|
| | | | | | *Impl. Status* | *Dev. Object*[2] | *Types of Problems*[3] |
| Through Appraisal | | | | | | | |
| Appraisal through Board Approval | | | | | | | |
| Supervision | 03/94 | 1 | 4 | FA | 1 (HS) | 1 (HS) | |
| | 02/95 | 1 | 2 | FA | S | S | |
| | 10/95 | 1 | 3 | FA | S | S | |
| | 07/96 | 1 | 5 | FA | U | S | Credit Line |
| | 05/97 | 1 | 6 | FA | S | S | |
| | 06/98 | 2 | 3 | E, PA | S | S | |
| Completion | 11/98 | 3 | 10 | E, OA,PA | S | S | |

1 – Key to Specialty Staff Skills:

FA = Financial Analyst; E = Economist; PA = Project Assistant; OA = Operations Analyst

2 = Key to Performance Ratings 3 = Key to Types of Problems

### Other Project Data

### Related Bank Loans/Credits

| *Loan/Credit Title* | *Purpose* | *Year of Approval* | *Status* |
|---|---|---|---|
| Preceding Operations | | | |
| 1. Agriculture Strategy | Agriculture | 1989 | Completed |
| 2. Integrated Agricultural Export | Agricultural Marketing | 1990 | Completed |
| 3. Agroprocessing | Agricultural Marketing | 1988 | Completed |
| 4. Agricultural Trade | Agriculture | 1992 | Completed |

### Follow-on Operations

This is expected to be the last Bank project in the agriculture sector.

**Product Market Development Project**

**Status of Loan Portfolio**

| PARTICIPATING BANK | Total Amount of Subloans Disbursed | | Total Subloan Outstanding | | Total Principal Matured | | Total Interest Overdue | |
|---|---|---|---|---|---|---|---|---|
| | HUF* | USD | HUF* | USD | HUF* | USD** | HUF* | USD |
| Kereskedelmi Bank Rt. | 2,296,059 | 19,334,754 | 674,097 | 5,676,606 | 20,654 | 173,928 | 6,788 | 57,162 |
| Budapest Bank Rt. | 264,737 | 1,994,999 | 184,184 | 831,793 | 2,311 | 10,322 | 0 | 0 |
| ABN AMRO (ex Magyar Hitelbank Rt.) | 217,700 | 2,150,224 | 0 | 0 | 0 | 0 | 0 | 0 |
| Mezobank Rt. | 1,496,689 | 13,925,357 | 167,334 | 747,461 | 9,918 | 44,303 | 1,813 | 8,100 |
| OTP es Kereskedelmi Bank Rt. | 78,560 | 576,370 | 41,599 | 0 | 0 | 0 | 0 | 0 |
| Konzumbank Rt. | 279,968 | 2,615,098 | 259,264 | 1,170,781 | 0 | 0 | 0 | 0 |
| MFB | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Inter-Europa Bank Rt. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | **4,633,713** | **40,596,802** | **1,326,478** | **8,426,641** | **32,883** | **228,553** | **8,601** | **65,262** |

* Thousand forint
** Exchange rate of August 31, 1998 1USD=223,87HUF

**Annex C**

**Borrower Response**

NATIONAL BANK OF HUNGARY

• DEPARTMENT FOR INTERNATIONAL FINANCIAL INSTITUTIONS •

**Mr. Madhur Gautam**
The World Bank
OED

Washington, D. C.

Budapest, July 3, 2000

Dear Mr. Gautam,

Re: 3509-HU PAR

On behalf of the National Bank of Hungary as Borrower we have no comments to the Performance Audit Report of the Product Market Development Project.

Looking forward to having further fruitful cooperation with the Bank

Sincerely

Éva Tarján
General Manager

*H-1850 Budapest V., Szabadság tér 8/9.*
*Phone: (36-1)302-3000, (36-1)269-4760 Telefax: (36-1)332-3913*