ICR Review
Operations Evaluation Department

Report Number : ICRR11451

1. Project Data:		Date Posted : 02/24/2003		
PROJ ID:	P039016		Appraisal	Actual
Project Name :	Fiscal Sustainability Credit (FSC) I	Project Costs (US$M)	140	177.2
Country:	Zambia	Loan/Credit (US$M)	140	177.2
Sector(s):	Board: EP - Compulsory pension and unemployment insurance (28%), Central government administration (19%), Banking (19%), Oil and gas (19%), Mining and other extractive (15%)	Cofinancing (US$M)		
L/C Number:	C3392			
		Board Approval (FY)		1
Partners involved :		Closing Date	12/31/2001	06/27/2002

Prepared by :	Reviewed by :	Group Manager :	Group:	
Elliott Hurwitz	Ridley Nelson	Kyle Peters	OEDCR	

2. Project Objectives and Components

a. Objectives

(1) Expand fiscal adjustment beyond the central government to other public sector entities (state-owned enterprises, pension funds, and the Bank of Zambia [BoZ]); (2) Reestablish fiscal discipline through improvement in the predictability, accountability, and transparency of public spending .

It was envisioned that the credit would directly contribute to the maintenance of a stable macroeconomic framework conducive to economic growth by ensuring that fiscal progress achieved during the last few years would be maintained. It was further envisioned that the proposed reforms in budgetary management would help ensure that public expenditures, especially social expenditures, would reach the poor in the most effective way .

b. Components

1. Zambia Electricity Supply Company (ZESCO)--Clear arrears; complete cost reduction measures; increase tariffs according to agreed criteria; improve billing and revenue collection .
2. Zambia National Oil Company (ZNOC)--Clear arrears to pipeline company; offer for sale majority share of ZNOC components; limit ZNOC to noncommercial operations.
3. Zambia Railways (ZR---Implement concessioning of ZR; develop strategy for restructuring and eventual privatization; establish independent regulatory body to enforce safety and environment -related regulations.
4. Bank of Zambia (BoZ)--Improve cash management and provision of funds to ministries; enhance BoZ power to de-license banks; create integrated database for recording and monitoring domestic and foreign debt .
5. Pension Reforms--Clear arrears to Public Service Pensions Fund (PSPF), and phase down PSPF, while strengthening NPS; publish NPS parameters (e.g., contributions, benefits); establish transparent governance structure for NPS; move NPS toward multi-pillar system; reduce NPS staff.
6. Improve Fiscal Management--Replace ad-hoc cash budgetary system by rule-based system (predictability); carefully monitor commitments and application of penalties to officers who exceed allocations (accountability); publish actual cash outlays as compared with planned allocation (transparency); share of social sector ministries to be at least 36% of the discretionary budget.

c. Comments on Project Cost, Financing and Dates

Of the original commitment of US$140 million, US$137.6 million was disbursed--in 3 tranches--with the difference due to exchange rate fluctuations. A first tranche of US$44.3 million was disbursed in August, 2000, a second of US$43.8 million in September, 2001, and a third of US$49.4 million in June, 2002. Supplemental amounts of US$39.59 million were disbursed due to oil shocks and Fifth Dimension credits . The project closed around six months later than planned due to delays in achieving some reforms, principally in the oil sector .

3. Achievement of Relevant Objectives:

1. ZESCO--The Copper Company reached agreement with ZESCO on the amount of debt and cross -debt, and it paid a cash settlement of US$15 million to ZESCO in May, 2001, to settle its indebtedness; final agreement was reached in October, 2002, on the amount owed to ZESCO by public sector entities. Additionally, ZESCO increased its tariffs by 25% prior to Board consideration of the FSC, and by an additional 16% in February, 2001, in accordance with agreed formulas.
2. ZNOC--Agreement was reached with the Tanzanian Government to concession the TAZAMA oil pipeline; the government of Zambia approved sale of a majority of shares in the INDENI refinery.
3. ZR--The process of concessioning ZR was started under the supervision of the Zambian Privatization Agency; substantial cuts were made in ZR staff; and financial operations improved (see section 4).
4. BoZ--The BoZ enhanced its power to de-license deficient banks, and also improved its cash management practices; the number of accounts held by government ministries was more than halved.
5. Pension Reforms--The NPS operating surplus increased; productivity of the NPS Authority increased, with around 80% of employees retrenched.
6. Fiscal management--Predictability: The Ministry of Finance was required to allocate to other ministries at least 80% of what they were scheduled to receive in the budget; Accountability: Line ministries that spent funds that were not approved were disciplined.

4. Significant Outcomes/Impacts:

- Zambian Railways went from an operating deficit of US$3.5 million in 2000 to an operating surplus of US$2.3 million in 2002
- The retail price of petroleum products was liberalized
- ZNOC was put under a liquidation plan, with its major assets offered for sale
- The BoZ has not issued any guarantees since the effectiveness of the FSC
- The BoZ adopted an UNCTAD computer-based system for recording both domestic and external debt
- The efficiency of NPS was significantly enhanced

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

- Most measures intended to improve the efficiency of public spending (objective 6) were not implemented
- The fiscal situation of the country did not improve during the period of the FSC (see section 6)
- A requirement that social sector ministries be allocated at least 36 percent of the discretionary budget (for 2000) was not met, and there appear to be issues with the definition of what expenditures were discretionary
- Progress toward a multi-pillar pension plan was less than envisioned

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	Most major relevant objectives were met, but with significant shortcomings: Key measures to improve the effectiveness of public spending and fiscal management were not implemented; and the requirement that social sector ministries be allocated at least 36% of the discretionary budget in 2000 was not met. Macroeconomic data (not contained in the ICR) do not show that the fiscal deficit improved during the time of the FSC: the fiscal deficit (including grants), which was -2.4% of GDP in 1999, rose to -5.0% in 2000 and -7.2% in 2001, before declining to -5.7% in 2002 (est). (data on the quasi-fiscal deficit are not available)
Institutional Dev .:	Modest	Modest	
Sustainability :	Likely	Unlikely	Most measures intended to increase budgetary accountability were not continued after the FSC was closed; the ICR acknowledges that public support for privatization was in doubt, that there was a lack of GoZ consensus for reform, that the privatization of the INDENI refinery was in doubt, and that the government asked the purchaser of the refinery to reduce its ownership share; the private firm that had purchased the country's

			largest copper mine (in March, 2000) pulled out of the project in February, 2002.
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:

- Before undertaking major reforms, consensus should be achieved between cognizant ministries
- A public information program is a key element supporting a reform agenda
- The amount of time allocated for important reforms was insufficient, and it would have been helpful to have a more systematic plan laying out each step of the reform process, and the linkages between actions, along with the estimated time required

8. Assessment Recommended? ● Yes ○ No

Why? It would be useful to quantify the savings produced by the project as well as the country's quasi-fiscal deficit during the period of the FSC.

9. Comments on Quality of ICR:

The ICR is unsatisfactory, as it does not present information critical to the evaluation. The ICR states that the FSC "directly contributed to the maintenance of a stable macroeconomic framework conducive to economic growth by ensuring the sustainability of the fiscal progress achieved in the preceding few years "--however, the ICR does not provide sufficient macroeconomic analysis to support the claim of a stable macroeconomic framework (see section 6). The ICR also does not provide information on the following measures specified in the President's Report : Evidence of improved ZESCO billing and revenue collection; establishment of an autonomous regulatory body to enforce ZR safety and environment-related regulations; strategies for restructuring/liquidating residual ZR functions after concessioning has become operational; publication in the National Gazette of NPS operational parameters.

In addition, the ICR makes a number of assertions for which little or no evidence is presented, for example : "The liberalization of prices, imports, and the liquidation of ZNOC appear irreversible, as does the concessioning of ZR." The ICR failed to note that the country's largest investor pulled out during the tenure of the FSC, an important factor in assessing sustainability. The evidence presented for Bank and Borrower Performance is also insufficient to justify the ratings. Finally, the ICR mistakenly states that "because this credit was an adjustment operation, the impact on institutional development was minimal," when in fact the project had the potential to make a substantial contribution.