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BOLIVIA

Institutional Reform Project

Credit No. 3245-BO

Proposed Amendment to the Development Credit Agreement

Introduction

1. This Memorandum seeks the approval of the Executive Directors to amend the Development Credit Agreement (DCA) for the Bolivia Institutional Reform Project (Loan No. 3245-BO).

2. The purpose of the proposed amendment is to restructure the Project's design and its comprehensive public sector reform approach to be more consistent with the government's strategy and country's possibilities for reform. Despite the difficult political and social situation in Bolivia, the Government maintains its commitment to advance in some of the reform areas covered by the project. For this purpose the government proposes: (i) the transfer of the Project's Technical Unit from the Ministry of Sustainable Development to the Ministry of Finance; (ii) cancellation of the components pertaining to *Part A – Performance-oriented Management and Evaluation of Public Sector Organizations* and *Part B – Combating Corruption*; (iii) correction of 1998 baseline and corresponding figures of Performance Benchmarks No. 3 and No. 4 for the period 2000-2004; and (iv) reallocation of amounts and redistribution of financial resources corresponding to category 3 – Salaries, as well as cancellation of SDR 1,204,424 (US$1.73 million equivalent) from the DCA. The government has also separately requested the extension of the projects' Closing Date until March 31st, 2006. The extension is currently being processed.

3. The restructuring will directly contribute to achieve the Project Development Objectives (PDO). To this purpose, the government has agreed with the Bank on a specific Action Plan and schedule whose execution until the end of the project will allow satisfactory project implementation. There are no outstanding audits for this Project.

4. The Project's disbursement percentage to date is 73%. The remaining balance of the Credit is approximately $8.48 million from an original amount of $35.34 million. Assuming a restructuring and extension, the project will execute an additional $6.75 million. The remaining funds up to $1.73 million will be canceled.

5. The following chart shows the IDA credit and related trust funds disbursement to date:

LOAN/TRUST FUND	AMOUNT US$ Millions	DISBURSED (May 2005) US$ Millions	UNDISBURSED (May 2005) US$ Millions	TO BE EXECUTED (June 2005-March 2006) US$ Millions	TO BE CANCELLED US$ Millions
IDA 32450	35.34	26.86	8.48	6.75	1.73
DANI-23393	12.97	8.65	4.32	3.30	1.02
SIDA-23885	8.99	6.46	2.53	2.00	0.53
NETH-23309	17.07	12.57	4.50	3.50	1.00
TOTAL	**74.37**	**54.54**	**19.83**	**15.55**	**4.28**

Background

6. The Institutional Reform Project (IRP I) was approved on June 15th, 1999 and became effective on December 15th, 1999. IRP I was envisioned as the first of three consecutive projects, within a 10-year APL program, whose central objectives would be to establish a merit-based civil service and progressively transform all of the central-government and departmental administrations into results-based agencies. The project has four substantive components. The first three (promoting laws and systems for performance evaluation, national integrity, and human-resource strengthening) were to support the fourth component – the heart of the IRP –broad institutional restructuring in six Pilot Agencies.

7. By the end of the 1990's a downturn in the economy began to make itself felt, and concurrently with the launch of the project a series of political events signaled fundamental changes in Bolivian politics. The traditional parties began to lose significant power in the face of new political demands enunciated by grassroots movements. While the framers of the project were aware of the political and economic risks typically involved in public-sector-reform projects like the IRP I, they did not anticipate the depth of change in Bolivia's political scene. Until 2002 the project – in its first phase of investing in systems and Institutional Reform Agreements (ARIs in Spanish) – was largely insulated from the incipient adverse climate because it had a strong political support. The project made substantial progress establishing a new Civil Service legal framework and six Institutional Reform Agreements (ARIs) were signed, in three Services (customs, tax, and roads) and three ministries (agriculture, housing, and education).

8. The Sanchez de Lozada administration that assumed power in August 2002 – in the middle of the IRP I's planned life – did not show strong commitment to the project. Project implementation was delayed and reforms such as the competitive selection of civil servants were discontinued as the government found that it interfered with its freedom to use public jobs and public agencies at its discretion. It was also concerned

that the more competitive wages that civil servants in Pilot Agencies were receiving under the project were aggravating fiscal pressures. The government's position had profound effects on the project. First, it led to the termination, by early 2004, of the ARIs with the three ministries on the basis of a lack of fiscal sustainability for the increased wage bill system. Second, the government suspended or delayed the required decisions and activities to implement the new Civil Service Legal Framework including the reforms to improve the government's human resources system and the competitive recruitment of civil servants. Third, there was neither a decision nor a plan to continue the implementation of the reforms of *Component A-Management by Results* and *B-Anticorruption*. Activities to continue the implementation of reform systems such as SISER (the results-based monitoring system), assets declaration, procurement, forensic audits and simplification of administrative procedures were discontinued. During 2003 the Bank's ratings of the Project IP and Project Management slipped from "satisfactory" to "unsatisfactory".

9. In late 2003-early 2004, after intense policy dialogue led by the Bank, the new Administration proposed a set of measures to re-launch the reforms. The first measures included the preparation of 12 new ARIs. Under these, the project paid incremental salaries for 12 agencies which had already incorporated at least 20 percent of their personnel under the new Civil Service Statute and agreed to continue with further incorporations, as well as other organizational and strategic improvements. Since mid 2004 the Government has given a strong impulse to the project as it is described below:

    a. Under *Component C-Civil Service* the new legal and regulatory framework has been entirely approved and nearly 3,500 civil servants representing 25% of the total public employees of the Central Government (excluding prefectures) were selected through competitive and transparent mechanisms, reducing the opportunities for political use of the public posts. The new 12 ARIs contributed to this result.

    b. Under *Component D-Organizational Reform of the Customs, Internal Revenue and Roads National Services'* reforms represent the main successes of the project. Three manifestly "failed" institutions – corrupt and inefficient – were turned around. Corruption has been reduced dramatically in all the agencies, the majority of their public servants have been selected using the transparent and competitive mechanisms established by the Civil Service regime and their performances demonstrate important advances in their appropriate functioning and service delivery. Despite the difficult political and economic situation of the country the main indicators of these agencies show important improvements: (i) IRS collection of taxes has substantially improved from 6.03% to 6.38% of GDP between 2003 and 2004; (ii) Customs processes show important improvements, for instance, the clearance time has been reduced to 1-2 days and all administrative procedures are processed through IT systems; and, (iii) roads maintenance costs have been reduced from US$ 3,000 for kilometer per year in 2001 to US$ 2,150 in 2004, an additional 2,000

kilometers have been added to the road network, paved roads increased from 3,786 km in 2002 to 4,073 km in 2004 and their cost is below the norm for the region: US$ 430 vs. US$ 450-550.

c. Under *Component E-Reform Management* the Minister of Finance has taken a strategic and leading role in the promotion and implementation of the above described reforms (the project's restructuring would designate the Ministry of Finance as the project's counterpart) and the extension of new ARIs to important agencies such as the Comptroller General's Office, the National Institute for Statistics and the Ministry of Finance itself.

Justification

10. Despite important project implementation advances executed by the Government, the last Implementation Status Report downgraded the Project Development Objective (PDO) to Unsatisfactory because the Closing Date on June 30th 2005 will not allow the government to complete the activities currently being executed and this in turn, will affect the fulfillment of the development objectives. However, the Closing Date is being extended until March 2006 allowing the execution of important activities to fulfill objectives of the project, particularly those related to components C, D and E. Besides, the overall Implementation Progress rating was upgraded to Moderately Satisfactory due to the important improvements in project implementation.

11. The restructuring of the project will allow it to adapt its content to the government's reform strategy aimed at enhancing reforms in Civil Service and key agencies closely related to Government revenues (Customs and IRS), Government expenditures (Roads Services) as well as to important agencies such as the Ministry of Finance. The success of the PDO depends on the completion of the on-going activities that would facilitate the consolidation of part of the institutional framework for a modern public sector (basically through Civil Service Reform) and building model agencies with improved delivery of services (Tax, Customs and Roads Agencies), as it is stated in the PDO description.

12. The activities to be executed during the extension's period will also contribute to the fulfillment of the actions included in the Multi Donor Program for Budget Support (PMAP in Spanish); facilitate the continuity of the Project Coordination Unit (whose performance was qualified as the best of the country's PCUs in the last portfolio review); and generate an opportunity for public sector policy dialogue.

13. As the IRP I was envisioned as the first of three consecutive projects, within a 10-year program, the restructure will also facilitate a smooth transition between the project and a proposed new operation for FY06. Annex 1 contains the letter sent by the Borrower requiring the project's restructure.

The Amendment

14. **Modification of the project counterpart to the Ministry of Finance.-** As components C (Civil Service) and D (Organizational Reform) are closely related to the Ministry of Finance's responsibilities, the Government has decided to assign the project counterpart to this Ministry. As a consequence, the Project's Technical Unit will be transferred to the Ministry of Finance.

15. **Cancellation of Component A of the Project: Performance-oriented Management and Evaluation of Public Sector Organizations.** The component's objective of establishing a results-based monitoring system (SISER) was formally achieved. But SISER falls well short of being part of a results-based budgeting system, as the IRP originally intended. The implementation of this component depended on the government delivering improved budgeting and financial-information systems. The financial-management reforms through SIGMA (financial information system) and the SAFCO Law (Administration and Governmental Control System) did not make enough progress to facilitate the implementation of a performance-oriented management system. These developments external to the project are central to understanding the limited development of this component. The government has recently agreed with the Bank, IMF, IDB, and donors' community to prepare a set of studies aimed to evaluate the current situation of SIGMA and propose a plan to improve its operation and performance. Besides, the Bank has finished an evaluation of the SAFCO systems which identifies their main implementation problems and suggests a set of measures to improve their performance. Until the proposed reforms to SIGMA and SAFCO systems are not in place, the government considers that the implementation of this component is no longer possible.

16. **Cancellation of Component B of the Project: *National Integrity/Combating Corruption*.** ($3.8 million spent by the end of 2004). This component included some of the tools in the international anti-corruption arsenal: an assets-declaration system, procurement, audit, and process simplification. The assets-declaration system appears to have proved useful to some agencies and procurement has become more transparent. These gains made a contribution to the overall goals of the project. The government has recently approved a National Anticorruption Plan to be financed by the donor community. The Plan includes further development of the tools developed by the project such as the evaluation of the assets-declarations system presented by the public employees and the execution of forensic audits.

17. **Correction of Project's benchmarks 3 and 4.** Schedule 4 of the DCA includes the project's performance benchmarks. In the case of Benchmark 3 the Government proposes to change the baseline data from 7.48% to 4.89% based in the amount collected in 1998. As a consequence, the benchmarks' figures for the following years are also corrected. For this purpose the government uses the proportion of collection's growth estimated in the original benchmarks. In the case of Benchmark 4 the government proposes a correction in the baseline data from 13,000 to 19,202 public employees. This is based on the Ministry of Finance's wage bill information. As a

consequence, the benchmark figures for the following years are also corrected. For this purpose the government uses the proportional reduction of public employees estimated in the original benchmarks.

18. **The cancellation of remaining funds up to $1.73 million.** The Action Plan agreed with the government will imply an execution of $6.75 million from the undisbursed $8.48 million (as of May 31, 2005) until the end of the project. $1.73 million will not be used and the government is requesting its cancellation. The requested adjustments will be reflected in the DCA's Schedule I: Withdrawals of the Proceeds of the Credit and related Cofinancing grants.

19. **Reallocation of funds within category 3 (Salaries).** The government is proposing a reallocation of proceeds within the same disbursement category.