ICR Review
Operations Evaluation Department

Report Number : ICRR11075

1. Project Data:		Date Posted :	08/14/2001	
PROJ ID :	P001401		Appraisal	Actual
Project Name :	Privatization/restructuring	Project Costs (US$M)	12.4	8.89
Country :	Lesotho	Loan/Credit (US$M)	12.4	8.89
Sector(s):	Board: PSD - Central government administration (55%), Law and justice (21%), General industry and trade sector (18%), Capital markets (6%)	Cofinancing (US$M)		
L/C Number :	C2612; CP845			
		Board Approval (FY)		94
Partners involved :		Closing Date	12/31/2000	12/31/2000
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2. Project Objectives and Components

a. Objectives

The project's objective was to promote the expansion of Lesotho's private sector as the leading element in a development strategy to diversify the economy, enhance growth, and increase employment and business opportunities. To these ends, the credit would support measures to (i) encourage the expansion of the role of the private sector in the economy through a privatization program including enterprises, banking, and utility sectors; (ii) enhance the competitive environment for private sector operations; (iii) encourage private investment in sectors that require the transfer of technology and the heavy infusion of capital; (iv) develop capital market instruments to support the enterprise reform and privatization effort; and (v) improve the efficiency and productivity of enterprises in the parastatal sector.

b. Components

Privatization ($4.2 million). Support was provided to: (i) implement a five-year program and to develop procedural guidelines for various aspects of privatization; (ii) help the privatization committee prepare enterprises for sale; (iii) undertake a public awareness program; and (iv) provide office equipment to support a newly established Privatization Unit.

Private Sector Development ($2.2 million). This component supported the following efforts: (i) strengthening the legal framework for the private sector through the development of a long-term strategy and action plan, and (ii) studies to develop action plans in areas where reforms were required to support private sector development (PSD). These include: (a) taking steps to address issues related to Lesotho's labor market (e.g., improving productivity) to encourage a greater use of the country's excess labor; (b) reviewing and revising the structure of utility tariff rates to make it consistent with the country's strategy for attracting investments in labor-intensive, export-oriented industries; (c) designing a future role for Lesotho National Development Corporation (LNDC) as a catalyst for private investment; and (d) reorienting the role of the Ministry of Trade and Industry to make it more supportive of the private sector. Additionally, the component supported efforts to strengthen key institutions for PSD : (a) the Ministry of Home Affairs to implement measures to ensure a more efficient allocation of urban and industrial land; (b) the Lesotho Investment Promotion Center to promote foreign investment; (c) the Business Advisory and Promotion Services to support indigenous investors; (d) the Lesotho Chamber of Commerce to enhance its capabilities; and (e) the Law Reform Commission.

Capital Market Development ($2.2 million). Assistance was provided to: (i) develop regulatory capability related to new capital market investments; (ii) prepare a prospectus for the Lesotho Investment Holdings (LIH) or the Lesotho Bank Unit Trust, or for both; (iii) assess the value of LNDC subsidiary companies to be sold through LIH or another unit trust; and (iv) market the unit trust shares to the private sector.

Training ($3.3 million). Training was provided to improve technical skills for: (i) implementing privatization at the level of the privatization committee and commercializing some enterprises not being privatized; (ii) improving the entrepreneurial and management capacity of retrenched workers and indigenous businessmen; and (iii) handling legal matters identified in the study of the commercial law reform strategy.

Implementation Fund ($3.3 million). The Fund was designed to provide finance investments that were identified by the legal framework study or other private sector development studies carried out under the project. However, this component was dropped when the project was restructured in 1997 and its funds were shifted to supporting privatization of utilities and banks.

c. Comments on Project Cost, Financing and Dates

At the mid-term review of December 1997, the project's objectives were revised to include an additional objective of accelerating privatization in the banking and utilities sectors (telecommunications, water, and electricity). Consequently, the Implementation Fund was canceled for a total of $ 3.0 million and funds were transferred to privatization of banking and utilities sectors. Subsequently, the project was structured in three major components: privatization of banking, public utilities, and enterprises; private sector development; and capital markets development, with the original training component folded in under all three.

3. Achievement of Relevant Objectives:

Privatization. The number of enterprises actually privatized has been less than anticipated. For a project that started in 1994, it is only recently that the privatization process has begun to accomplish some progress. Only 10 enterprises out of 32 were successfully privatized for a project that was intended to support the privatization of at least four enterprises each year. However, the past year has seen intensified project activities with marked signs of accelerated progress. For example, negotiations with Standard Bank of South Africa led to the agreement whereby Standard Bank Lesotho took over control of Lesotho Bank (with a 70 percent shareholding). A liquidator was appointed for Lesotho Agricultural Development Bank, following its closure. Of the three public utilities (electricity, water, and telecommunication) only the Lesotho Telecommunications Corporation was privatized in February 2001, with 70 percent being sold to the private sector. Additional Bank support for restructuring public utilities will be provided under the new Utilities Sector Reform Project (USRP).

Private Sector Development. The studies on legal framework, utility tariffs, and labor market were completed on time. However, no evidence was provided on whether these studies provided valuable information that enabled the adoption of reforms supporting PSD. For example, there is no indication that the labor market study has helped in improving worker productivity, implementing changes in wage rates, or improving strained labor relations. In the event, the beginning of the 1998/99 fiscal year witnessed a 10 percent across-the-board public sector wage increase, contributing to a large increase (7.5 percent) in current expenditures. The 1998/99 budget deficit more than doubled to 4.2% of GNP from the previous year. The Lesotho Commercial Court has been established recently (May 2000) and has reviewed only 2 cases. The Investment Promotion Center (IPC), supported by the project to promote foreign investment, made several attempts to promote enterprises to be privatized but could not yield positive results. The civil unrest that followed the 1998 elections resulted in a large-scale destruction of private businesses, particularly foreign-owned, and significantly eroded business confidence. Surveys conducted in the wake of riots showed that over 1,000 businesses reported damage of more than $43 million to premises, with close to 6,000 jobs being lost (Sechaba Consultants, 2000, *Poverty and Livelihood in Lesotho*). A UNDP/Wold Bank mission estimated the total cost of reconstructing damaged properties at Maloti 160 million or US$34 million (*Post-Conflict Needs Assessment*). Unemployment remained extremely high, about 40 percent.

Training. About 486 retrenched workers received training through the Entrepreneurship Training Program. Sixty percent of those trained are utilizing their new acquired skills. However, the number of retrenched staff was 1,200 instead of the estimated 500.

Capital Market Development. This component also experienced slow progress due to a limited number of profitable enterprises, a weak financial system and a lack of technical capacity. The Unit Trust was recently established and will become operational by end-July 2001, while the privatization Trust will be completed under the new USRP.

4. Significant Outcomes/Impacts:

Privatization of some major enterprises and of the Lesotho Telecommunication Corporations (see section 3).

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

The privatization component of the project has been rated unsatisfactory by the Project Status Report (PSR), except for the last two PSRs dated June 2001 and December 2000. There were considerable delays in the privatization process due to multiple consultations both in cabinet and parliament about each stage. It seems that the project design did not accurately take account of the extent of vested interests against privatization. A principal aspect of reluctance to privatize is the concern that Lesotho does not have enough capital and entrepreneurial capacity and that privatization would mean foreign ownership, particularly South African. This risk was supposed to be mitigated by a strategy in which the first phase of privatization would favor indigenous investors. This did not happen. The first enterprise to be privatized, Lesotho Airways, was bought by a Southern African company, resulting in the retrenchment of all the workers and giving proof to observers of the negative label that had been used by labor unions in warning Basothos against privatization. The process of promoting indigenous ownership of privatized enterprises has also been slow. By the end of the project, Basothos bought only three enterprises. This outcome is explained mainly by: (i) Lesotho's weak endogenous private sector (dominated by microenterprises employing no more than one or two workers and operating mainly in rural areas); and (ii) the difficulty for national entrepreneurs to access capital due to the lack of collateral, weaknesses in the financial sector, and inadequate legislative and

business environment.
The development of a capital market was not appropriate to create a dynamic private sector in Lesotho given the country's private sector profile, which was characterized as small and foreign -dominated with inadequate financial accountability. Moreover, the weakness of the banking system, which is the main component of any vital functioning capital market, was an indication of the inappropriateness of the strategy . The banking sector in Lesotho was unable to perform very basic functions essential for an equity market such as credit provision, clearing and settlement trades. In any case, considering a capital market in the context of Lesotho remains a unrealistic strategy given its proximity to the Republic of South Africa (RSA) where such a market is well developed and operates competitively with international standards. Not surprisingly, the implementation of this objective proved to be slow . The Unit Trust and the Privatization Trust Fund, the two critical institution components in the project aimed at promoting local minority shareholder participation in the privatized enterprises, were yet to be functional . The Unit Trust has recently been established and will become functional by end of July 2001. The Privatization Trust will be completed under the new USRP.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Unsatisfactory	There is little evidence indicating that the project achieved its development of enhancing Lesotho's private sector development (see section 5). Substantial relevance (marred by continued inefficiencies in public utilities, weaknesses in the financial sector, and inadequate business environment) was coupled with modest efficacy. Project achievements are tempered by a number of shortcomings with respect to both project expectations for more privatization and the needs of the country in terms of banking and financial intermediation development. Furthermore, the political instability continued to discourage investment.
Institutional Dev .:	Substantial	Modest	The Bank’s contribution to institutional changes was modest because most of the institutions supported were characterized by weak management and lack of funds.
Sustainability :	Likely	Non-evaluable	Sustainability of benefits depends mainly on continuing large inflows of aid and increase in foreign direct investment, all of which are uncertain. An improved environment for private sector development and growth depends also on enhanced political stability, better governance, deeper parastatal reform, and a stronger financial sector. Prospects for all of these changes are difficult to assess.
Bank Performance :	Satisfactory	Satisfactory	The quality at entry was unsatisfactory, as the ICR acknowledged. Complexity in project design characterized by multiple objectives and implementing agencies, and absence of monitoring and evaluation made supervision difficult. Nonetheless, intensive supervision and appropriate mid-term adjustments kept the project.
Borrower Perf .:	Satisfactory	Unsatisfactory	The borrower underestimated its implementation capacity in adopting an overly ambitious and complex project with multiple objectives, and involving several implementing agencies, and without strong coordination, monitoring and

			evaluation mechanisms. Also, the government underestimated the extent of vested interests against privatization. As a result, project implementation faced many difficulties.
Quality of ICR :		Satisfactory	

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

7. Lessons of Broad Applicability:

- Privatization and economic restructuring are politically sensitive processes. When undertaking an ambitious sector reform such as this, the Bank should provide adequate support to promote broad consensus within and outside the government. The Bank should exercise sufficient prudence in the project design (i.e., quality at entry should not be compromised).

8. Assessment Recommended? ● Yes ○ No

Why? The Regional staff disagrees with most of the ICR Review - Evaluation Summary ratings. Given that most activities supported by the project are very recent and are expected to be completed under the follow -up USRP operation, a cluster audit with the new USRP may provide a better assessment.

9. Comments on Quality of ICR:

The ICR is of satisfactory quality, describing the shortcomings in achievement and the difficulties in implementation. However, only some of the achievements are described with reference to results on the ground. For example, no evidence is provided on the following two developmental objectives : (i) whether the objective of encouraging private investment in sectors that require the transfer of technology and the heavy infusion of capital was achieved or not; and (ii) whether the efficiency and productivity of enterprises currently in the parastatal sector were improved or not. The Borrower's own report is included in the ICR.