ICR Review

Operations Evaluation Department

Report Number : ICRR11675

1. Project Data:		Date Posted : 01/29/2004		
PROJ ID :	P040557		Appraisal	Actual
Project Name :	Erso Ii	Project Costs (US$M)	180.0	182.7
Country:	Ghana	Loan/Credit (US$M)	180.0	182.7
Sector(s):	Board: EP - General public administration sector (40%), General finance sector (20%), General agriculture fishing and forestry sector (16%), General energy sector (12%), General transportation sector (12%)	Cofinancing (US$M)		
L/C Number:	C3228; CQ128			
		Board Approval (FY)		99
Partners involved :		Closing Date	06/30/2001	06/30/2003

Prepared by :	Reviewed by :	Group Manager :	Group:
Michael R. Lav	Soniya Carvalho	Kyle Peters	OEDCR

2. Project Objectives and Components

a. Objectives

To consolidate recent gains in restoring macroeconomic stability and support implementation of further reforms in the cocoa, energy, and banking sectors . The credit also provided foreign exchange to bolster Ghana's vulnerable external position while counterpart financing generated for the budget was intended to reduce the deficit thereby dampening inflation and lowering interest rates .

b. Components

The broad project components were macroeconomic stability and fiscal reform, and structural reforms .

The project as amended comprised two fixed and two floating tranches, one for the Ghana Commercial Bank (GCB) reforms, and a second for the Electricity Company of Ghana (ECG) reforms. Conditions under the **first tranche** included: (A) fiscal reform: (1) increase the efficiency of public spending by terminating contracts underlying 70 percent of road arrears and eliminate all road arrears by the year 2000, implement a new budget and expenditure (BPEMS) system for targeted ministries, and (2) reduce distortions by removing a special tax of 17.5 percent levied on certain imports, complete a comprehensive review of the tariff regime, and reduce the tariff top rate to 20 percent in harmony with the subregion; (B) cocoa sector reform: (1) cabinet approval of a medium term strategy to accelerate increases in the farmers' share of fob price and allowing qualified licensed firms to export 30 percent of cocoa purchases, (2) publicly announce the revised medium term strategy for cocoa and an implementation timetable, (3) issue instructions to ensure that all cocoa licensed buying companies will have equal access to Cocobod financing, (4) offer for sale the Produce Buying Company; (C) energy sector reform: (1) publish a statement of power sector development policy agreeable to IDA, (2) complete and issue a Transitional Power System Development Plan, (3) publish and implement complete guidelines for fixing electricity tariffs, (4) complete separation of electricity transmission utility from the Volta River Authority, and (D) financial sector reforms: (1) establish quarterly targets for banks not meeting capital adequacy requirements, including limits on deposit mobilization and lending, (2) agree on a strategy to resolve the insolvent positions of the Bank for Housing and Construction (BHC) and the Cooperative Bank, (3) select a strategic investor for National Investment Bank (NIB) or re-launch search with assistance of a financial advisor, (4) complete study on role of ADB in rural finance, (5) implement revised guidelines for foreign currency exposure limits, and (5) submit a revised draft central bank law and banking law to parliament . Conditions for **second tranche** comprised: (A) cocoa sector reform (1) Increase farmers' share in fob price to 65 percent in the 1999/2000 crop season, and (2) issue instructions to allow qualified cocoa licensed buying companies to export 30 percent of their domestic purchases starting with the 2000/01 crop, (B) energy sector reform - Submit to Parliament the legislative instrument establishing the electricity regulations for the operation of the National Interconnected System, and (C) financial sector reform - withdraw the licenses of banks not meeting the capital adequacy ratio requirement. The condition for the ECG **floating tranche** was to offer for sale ECG's distribution units. The condition for the GCB floating tranche was to offer for sale 30 percent of GCB's shares to a strategic investor and place remaining shares on the Ghana Stock Exchange.

c. Comments on Project Cost, Financing and Dates

The close correspondence between appraisal and actual costs is the result of offsetting changes during implementation. Project cost in the original credit agreement was US$ 180.0 million, or 132.7 million SDRs in three tranches, a first and a second tranche each for 59 million SDRs and a floating tranche (ECG tranche) for 14.7 million SDRs. An IDA reflow for SDRs 1.3 million was attached to the first tranche at signing, and an IDA reflow of 900,000 SDRs was attached to the second tranche with an amendment dated June 28, 2000. An amendment on September 8, 2000 divided the second tranche into a smaller tranche for 37 million SDRs and a second floating tranche (GCB tranche) for 20.7 million SDRs. A third amendment on September 20, 2000 created a supplemental tranche of SDR 37 million to address severe terms of trade shock. (A fourth amendment on February 23, 2001, separated out IDA reflows from the fixed tranches into two new disbursement categories, one for an IDA reflow of 1.3 million and a second IDA reflow category for SDR 900,000.) The first tranche, the restructured second tranche, the supplemental tranche, and the IDA reflows were disbursed, for a total of SDRs 135.2. The GCB and ECG floating tranches for SDRs 34.7 million were cancelled. The project cost of SDRs 135.2 million was financed by these disbursements. The loan was appraised on April 8, 1999, approved by the Board on May 27, 1999, made effective on July 23, 1999, and closed on June 30, 2003, two years behind schedule.

3. Achievement of Relevant Objectives:

The project failed to achieve its major relevant objectives (see Section 5). Conditions for **first tranche** which were achieved included: (A) Fiscal Reform (1) the government implemented a new budget and expenditure (BPEMS) system for targeted ministries in 2003, and (2) The effective top tariff rate was set at 20 percent in 2002 and a new import tariff regime with four rates was introduced. (B) Cocoa Sector Reform comprising (1) cabinet approval of a medium term strategy to accelerate increases in the farmers' share of fob price and to allow qualified licensed firms to export 30 percent of cocoa purchases in a decree dated August 30th, 2000. The ICR does not comment on whether a medium term strategy for cocoa was developed strategy for cocoa and an implementation timetable. The Produce Buying Company was divested in December 1999; (C) Energy Sector Reform (1) The ICR implies but does not state that the Government completed and issued a Transitional Power System Development Plan, (2) electricity tariffs were increased by 60 percent and 12 percent and granted the authority to change utility tariffs for the PURC, using automatic adjustment formulae. (D) Financial Sector Reforms -The revised draft central bank law and banking law was submitted to parliament and passed. Conditions under the **second tranche** which were achieved comprised: (A) Cocoa Sector Reform (1) The Government increased farmers' share in fob price to 65 percent in the 1999/2000 crop season, and taxes on cocoa exports were reduced to 16 percent in 2003. (2) The Government issued instructions to allow qualified cocoa licensed buying companies to export 30 percent of their domestic purchases starting with the 2000/01 crop, but no firms qualified for licenses. (B) Financial Sector Reform. The licenses of three banks were withdrawn for failing to meet capital adequacy requirements.

4. Significant Outcomes/Impacts:

None of the impact indicators specified in the President's Report achieved the projected target. 1. Domestic interest payments as percent of total recurrent expenditures were projected in the President's report to drop from 30.1 percent in 1998 to 16.0 percent in 2001, but the actual for 2001 was 30.5 percent. 2. Expenditures on health and education as a % of total domestically financed expenditures were to increase from 22 % in 1998 to 29% in 2001, but were only 26%. 3. Road arrears as percent of GDP were projected to decline from 0.8 percent in 1998 to 0.0 percent in 2001, but instead dropped to 0.1 percent. 4. Coca exports (hundred thousand tons) were projected to increase from 382 in 1998 to 434 in 2001, but reached only 394. 5. Non-performing loans in the banking system as a percent of the total were projected to decline from 23 in 1998 to 12 in 2001, but only declined to 19.6 in 2001. 6. Private investment was projected to increase from 11.6 percent of GDP in 1998 to 14.8 percent in 2001, but reached only 13.8 percent.

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

The operation was not successful in helping Ghana address the terms of trade loss and implement an adjustment program to substantially improve macroeconomic indicators such as interest payments or non -performing assets of the banking system. The fact that none of the impact indicators was met (see section 4) indicates serious shortcomings in the design and implementation of this credit. Another important aspect of shortfalls is the spotty record of implementation of project conditions. Although specific second tranche release conditions were met, the large number of unmet conditions, beyond the floating tranche conditions which were not met, signals an important shortfall in Government performance and in the role played by the Bank. These include the following. All road arrears were not eliminated by 2000. A strategic investor for NIB was apparently not selected. Government did not increase petroleum prices as agreed and incurred large deficits in the refinery operations which were financed by the GCB. The GCB was not divested. Concerning energy sector reform, the government submitted to Parliament the legislative instrument establishing the electricity regulations for the operation of the National Interconnected System but the Parliament sent back the proposal and it has not been passed. The restructuring plan for the unbundling of transmission and generation activities of the VRA was not completed. The ECG was not divested.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Unsatisfactory	Unsatisfactory	
Institutional Dev .:	Negligible	Negligible	
Sustainability :	Unlikely	Unlikely	
Bank Performance :	Unsatisfactory	Unsatisfactory	
Borrower Perf .:	Unsatisfactory	Unsatisfactory	
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:

1. The ICR cites lack of capacity in the Ministry of Finance as a reason why this project failed . Yet, the Bank had worked closely with the Ministry of Finance in previous adjustment operations, leading one to suspect that the Bank's eagerness to provide financing as a response to a quickly evolving government financial crisis was the important factor, overriding concerns about capacity . The lesson is that even in times of stress, as Ghana faced with the terms of trade decline in 1999 and 2000, capacity constraints need to be addressed . 2. Failure to raise petroleum prices as needed generated a large deficit which was partly financed by the GCB, thereby undermining efforts to privatize GCB as previously interested international banks lost interest with the deterioration in GCB's balance sheet . The best way to address this would have been to make pricing reforms a condition of credit negotiations . The lesson is that key reforms should be implemented up front and not left to implementation during adjustment operations .

8. Assessment Recommended? ● Yes ○ No

Why? The Bank has extended a substantial amount of support to Ghana, including this important operation, which was a complex operation quickly formulated to help respond to a financial crisis . The shortfalls in implementation will have a serious adverse development impact on Ghana, and a performance assessment for the ERSO credits would be important to better assess how well the Bank is assisting the country .

9. Comments on Quality of ICR:

The ICR is rated satisfactory because it captures the important features of this complex operation and identifies the key shortcomings. However, the ICR should have included a table on project costs and financing (the standard Annex 2) instead of just stating in Annex 2 that this information was available electronically, especially in this case where tranching was more complex than usual. In addition, the ICR does not comment specifically on whether several tranche release condition were met, including whether (1) the study on the role of ADB in rural finance was completed and (2) the revised guidelines for foreign currency exposure limits were implemented .