ICR Review
Operations Evaluation Department

Report Number: ICRR10961

1. Project Data:		**Date Posted:**	07/10/2001	
PROJ ID:	P035641		**Appraisal**	**Actual**
Project Name:	Public Sector Reform and Export Promotion (PSREP)	**Project Costs (US$M)**	170	167.6
Country:	Zambia	**Loan/Credit (US$M)**	170	167.6
Sector(s):	Board: EP - Central government administration (33%), Mining and other extractive (28%), Other domestic and international trade (17%), Other social services (11%), General industry and trade sector (11%)	**Cofinancing (US$M)**		
L/C Number:	C3167			
		Board Approval (FY)		99
Partners involved:	none	**Closing Date**	12/31/2000	12/31/2000
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2. Project Objectives and Components

a. Objectives

To support Zambia's economic reform program, which aims at reducing widespread poverty by promoting broadly-shared private-sector led growth and improving delivery of social services. In particular, the credit supported measures to: i) facilitate the completion of the privatization of the copper parastatal, ZCCM, by assisting in its labor reduction program; ii) improve the performance of the public service by reforming pay and employment practices and improving management controls; iii) promote private investment, particularly in export-oriented activity, by improving access to imported inputs and streamlining investment approvals, and; iv) strengthen the delivery of social services by monitoring budget allocations to key social expenditure categories and supporting key policy reforms.

b. Components

Balance of payments support linked to economic and social reforms as follows:

I. **Supporting ZCCM Privatization.** Transfer of ownership of remaining ZCCM assets to private sector, transformation of rump ZCCM into an investment holding company and satisfactory completion of the ZCCM labor retrenchment and retraining program.

II. **Public Service Reform.** Adoption of initial Public Sector Reform Program (PSRP) action plan, progress in reducing payroll and tightening establishment controls, adoption of a revised action and implementation plan for PSRP and its initial implementation.

III. **Export and Investment Promotion.** Elimination of the Import Declaration Fee (IDF), announcement and implementation of measures to enhance Duty Drawback Scheme (DDB) and Manufacturing Under Bond Scheme (MUB), agreement on action plan and initial implementation of measures to streamline investment approval and promotion processes.

IV. **Social Services.** Agreement on funding levels for social services in 1999, and satisfactory implementation based on monitoring of actual expenditures for social services.

c. Comments on Project Cost, Financing and Dates

1st Tranche: US$65 million equivalent released 1/28/99; Floating Tranche: US$ 37.6 million equivalent released on 7/29/99; 2nd Tranche: US$65 million equivalent released 4/3/2000, nearly a year later than expected due to delays in ZCCM asset transfer. An amount of US$68.5 million was on-lent by Government to the copper parastatal, ZCCM, to finance retrenchment packages and worker retraining programs .

3. Achievement of Relevant Objectives:

i) facilitate the completion of the privatization of the copper parastatal, ZCCM, by assisting in its labor reduction program.

In March 1999, ZCCM was converted into an investment holding company according to a reorganization plan approved by its Board. Remaining core assets of ZCCM were transferred to private ownership on March 31, 2000. The labor reduction component was completed on March 31, 2001, per the revised deadline agreed with IDA. PSREP 2nd tranche was released on the basis of a satisfactory interim audit on retrenchment and retraining payments as of January 2000. A final audit has been presented to the Bank in June, 2001. The balance of on-lending to ZCCM-IH will be used for environmental clean-up as agreed with IDA.

ii) improve the performance of the public service by reforming pay and employment practices and improving management controls.

Cabinet approved the 1997 PSRP Action Plan in time for Board Presentation, then updated the plan and prepared an implementation schedule for 2000-2002. The updated plan, entitled PSRP2000 was adopted by Cabinet in June 1999. The civil service was reduced from 117,000 workers at end-1998 to around 102,000 at end-2000, exceeding targets agreed in the LDP. Beyond downsizing, no evidence is presented on implementation of reforms for pay and employment practices or management controls.

iii) promote private investment, particularly in export-oriented activity, by improving access to imported inputs and streamlining investment approvals.

The Import Declaration Fee was eliminated in July 1998. The MUB and DDB schemes were revamped, and regulations issued in July 1999. The government subsequently decided to eliminate the MUB in favor of the DDB scheme alone. Revision of the DDB scheme reduced processing time for duty drawbacks from 180 days in March 1998 to 30 days in December 1999 and beyond. However, use of the DDB scheme is limited to about 75 registered companies, of which only about two-thirds are active users. With respect to investment promotion, agreement was not reached on establishing a "one-stop shop" for investment approvals at the Investment Center. Instead, measures were taken to improve coordination among various authorizing /licensing agencies, so that investment approvals are granted through regular meetings of all relevant agencies . However, this was not followed by an increase in investment applications in the 1999-2000 period.

iv) strengthen the delivery of social services by monitoring budget allocations to key social expenditure categories and supporting key policy reforms.

Actual spending for agreed social expenditures was 36 percent of the discretionary budget in 1999, per agreement with IDA. Cash releases for the seven targeted social programs were as agreed . However, due to a shrinking discretionary budget, real spending in the social sectors continued its long -term decline. Furthermore, leakages between Ministry of Finance and technical ministries, poor expenditure control at the technical level and procedures for ad hoc reallocation of funds at the technical level make it difficult to assess actual spending for social services and programs. The on-going Fiscal Sustainability Credit begins to address these weaknesses . Despite inclusion in the stated objectives, the PSREP credit did not support other policy reforms related to social service delivery .

4. Significant Outcomes/Impacts:

1) Privatization of the copper mines in early 2000 cemented the transition from the state-controlled economy of pre-1991, and eliminated what had been the major constraint to economic recovery in the second half of the 1990s. In the 1996-99 period, the parastatal copper mines suffered operating losses equivalent to six percent of GDP per annum, and were a severe drag on economic growth. Since privatization in early 2000, investments in the mines have stimulated a relative economic boom in the Copperbelt region. Copper production and exports are expected to double within two years, and have already increased significantly in the year since privatization . Real growth of GDP in 2001 and 2002 is expected to reach the 5-6 percent range. Labor adjustment was successfully completed, involving layoff, provision of terminal benefits and support programs for nearly 10,000 worker from ZCCM.

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

1) While inclusion of the retrenchment component in this credit created incentives for rapid closure of mining privatization, earlier Bank adjustment lending and technical assistance credits created financial incentives and provided cushioning that may have contributed to slower progress on privatization . Collapse of earlier privatization deals in 1998 proved extremely costly for the country, the government and the Bank .

2) The QAG review on quality at entry flags inadequate attention to the social (provision of municipal services) and

environmental aspects of mining privatization. The Bank has subsequently supported the Mining Townships Services Project to address social concerns, but the planned Copperbelt Environment Project has not yet been approved by the Bank, although preparation is underway.

3) As summarized in the QAG review of quality at entry: "Other than privatization of ZCCM, the operation does not seem to have gone far enough in supporting the implementation of irreversible reforms " Timing was driven largely by Zambia's balance of payments needs, so that "the reforms supported are those that happen to be achievable at the particular time", rather than the most critical steps within a longer-term reform program aimed at improving public sector efficiency, promoting exports or enhancing delivery of social services. In these three areas:

a) public sector reform. Conditionality focused on adoption of action plans, although the PSRP process had been underway since 1993. Previous adjustment operations included conditionality related to downsizing. This operation included no monitorable indicators for implementation of the action plan, apart from government commitment to further downsizing as expressed in the LDP. The credit had no impact on employment and pay policies or management controls as defined in objectives.

b) export and investment promotion. Both the number of investment applications and the growth of non-traditional exports (i.e. non-metal exports) slowed despite measures in these areas. Program impact could have benefited from analysis and business surveys to better define the constraints to investment and exporting. Conditionality focused on enhancing existing schemes in order to eliminate remaining "anti-export bias", but did not explicitly consider the "anti-import bias" of regional trading partners, nor analyze the broader issue of effective protection levels for both export- and domestically-oriented sectors.

c) delivery of social services. Efforts to protect social spending were only partially successful, with cash releases declining in real terms over time, and unclear allocation of cash releases at the technical level. Apart from budget resource allocation, the credit had no impact on delivery of social services.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	Overriding importance of privatizing the copper mines dictates a satisfactory rating, but only moderately so considering the costly delays in mining privatization, and the failure of the credit to bring about important and irreversible reforms in the three other target areas.
Institutional Dev .:	Modest	Modest	Improved coordination of agencies involved in investment approval. Privatization of mines altered underlying public/private institutional structure of economy. Smooth labor adjustment enhanced productivity of privatized mines and improved country's ability to make more efficient use of human resources.
Sustainability:	Likely	Likely	Net benefits derive almost exclusively from privatization of mines, which is unlikely to be reversed.
Bank Performance:	Satisfactory	Satisfactory	On balance, satisfactory, but only moderately so. This reflects the leading role of the Bank in supporting mining privatization, and use of PSREP to facilitate labor adjustment. However, poor performance in appraising conditions related to three of the four objectives resulted in limited impact.
Borrower Perf .:	Satisfactory	Satisfactory	On balance, satisfactory, but only moderately so. Within this operation, the borrower acted in a timely fashion to conclude the mining privatization, which had been subject to lengthy delays and foot-dragging in earlier phases. The borrower also demonstrated weak

			commitment to implementation of the PSRP, and shares responsibility for limited impact of agreed measures in other areas.
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 Bank must carefully assess the impact of adjustment lending and related technical assistance credits on sensitive privatization transactions, particularly in high -need balance of payments situations. Disbursement timing, conditionality and institutional or program funding should all send appropriate messages and create appropriate incentives for transparent and timely action on agreed privatization . In this case, IDA's earlier BOP support cushioned mining losses, but failed to provide added incentives (e.g. funding labor retrenchment) or results-oriented conditionality to conclude the privatization. Technical assistance funding for the negotiating team also lacked results-based financial incentives.

2) Sequencing of privatization can have a significant impact on economic recovery . Earlier tackling of large, important privatizations such as the mines would have led to faster economic recovery, in turn contributing to continued political will and public acceptance of reform .

3) Weak conditionality limits the impact of adjustment lending . Adoption of action plans (e.g. PSRP) should be linked to monitorable indicators of implementation progress as a trigger for tranche release .

4) Thorough analysis of the trade regime and effective protection (including an assessment of the regional trade environment) and of the business environment is necessary to design effective reforms for investment and export promotion.

5) Macroeconomic adjustment operations should avoid overstating the impact of social expenditure protection, which is just one step--and often only a modestly effective one --toward improved delivery of social services.

8. Assessment Recommended? ● Yes ○ No

Why? This operation is included in a cluster audit of adjustment lending in Zambia, which will serve as an input to the upcoming OED Country Assistance Evaluation .

9. Comments on Quality of ICR:

Thorough and well-presented. However, ICR tends to inflate net benefits of PSREP through reference to benefits derived either from past interventions or unsupported by the Bank (e.g. non-mining privatization, reform of public welfare assistance scheme). ICR accurately describes past delays in mining privatization --and borrower/Bank role in these delays--but isn't clear enough in ascribing this delay to actions in the 1995-98 period that are not directly related to this operation.