Report Number : ICRR12582

IEG ICR Review
Independent Evaluation Group

1. Project Data:		**Date Posted :**	03/26/2007	
PROJ ID :	P040631		**Appraisal**	**Actual**
Project Name :	Zm-Economic Management and Growth Credit	**Project Costs (US$M)**	40.0	40.0
Country :	Zambia	**Loan/Credit (US$M)**	40.0	40.0
Sector(s):	Board: EP - Central government administration (45%), General finance sector (20%), Compulsory pension and unemployment insurance (15%), General energy sector (10%), Telecommunications (10%)	**Cofinancing (US$M)**		
L/C Number :	C4009			
		Board Approval (FY)		05
Partners involved :		**Closing Date**	12/31/2005	12/31/2005
Evaluator :	**Panel Reviewer :**	**Division Manager :**	**Division :**	
Elliott Hurwitz	Chad Leechor	Ali Khadr	IEGCR	

2. Project Objectives and Components

a. Objectives

Help sustain the current economic recovery through reforms that :

1. Strengthen the macroeconomic environment
2. Advance financial sector performance
3. Improve public sector management
4. Improve Zambia's business environment.

b. Components (or Key Conditions in the case of Adjustment Loans):

<u>Strengthen macroeconomic environment</u>

- Correct macroeconomic imbalances
  --Maintain appropriate macro policy framework
  --Cabinet decision empowering utilities to treat government customers as they would private customers
  --Accountant General instructs accounting officers to pay agency bills on time
  --Secretary of Treasury issues letter to utilities reiterating Cabinet decision
  --Ministry of Finance and National Planning (MoFNP) adopts time-bound plan for payment of Government arrears to utilities
- Work toward financially sustainable pension system
  --Public Service Pension Board (PSPB) approves reforms in benefit formulas and contribution rates
  --PSPB completes draft 3-year plan to reduce administrative expenses
  --National Pension Scheme Authority adopts revised investment policy, drafts manual on corporate governance, and develops training program for trustees.

<u>Improve financial sector performance</u>

- Resolve state-owned non-bank financial institutions
  --Cabinet approves Financial Sector Development Plan (FSDP) stipulating legal changes such that non-bank financial institutions can be incorporated under the Companies act, and strengthening supervision of these institutions by the National Bank of Zambia
  --Borrower makes progress in implementing above legal changes and commences implementation of FSDP
  --Development Bank of Zambia ceases to take deposits or borrow with a government guarantee
- Build better governance structure for the bank of Zambia
- Promote better credit culture

<u>Improve public sector management</u>

- Upgrade government's debt management capability to support fiscal sustainability
- Improve public expenditure management and financial accountability practices

--MoFNP submits recommendations to Constitutional Review Committee (which has been working on a general constitutional revision) that enable more timely passage of Budget Act, restrict retroactive approval of supplementary appropriations, and expand duties of the Auditor General
--Cabinet submits to Parliament revised Financial Act to better define role of The Treasury, establish agency audit committees, enhance oversight, and prohibit expenditures greater than the amount appropriated
--Cabinet agrees to approve any budget supplementals and to show where funding will increase and where it will be reduced as a result of the supplementals
--MoFNP submits Green Paper to Cabinet in 2004 with 3-year indicative budget ceilings for agencies
--MoFNP develops 2005 annual budget that includes inter-year spending comparisons and clear identification of Personal Emoluments* (PE) from government resources

- Streamline Ministerial structures and improve incentives for service delivery
  --Cabinet Office's Public Sector Management Division consolidates most allowances into base salary and reduces ratio of allowances to base salary, subject to identification of the fiscal implications of these actions and negotiations with trade unions
  --MoFNP: transfers payroll to Payroll Management and Establishment Control (PMEC) system; trains users in this system; bases PEs on PMEC; ceases to pay public servants not occupying an identified position.

Improve Zambia's business environment.

- Enhance private sector development
- Improve legal and regulatory environment for network utilities

*Personal Emoluments are additional compensation or perquisites received by public employees

c. Comments on Project Cost, Financing, Borrower Contribution, and Dates

The second tranche disbursed around 6 months later than expected due to delays in achieving public sector management reforms. The credit closed on schedule in December, 2005.

3. Relevance of Objectives & Design :

The objectives were consistent with the Country Strategy and address development barriers that are important to the country. However, relevance was *modest* due to (1) the use of an inappropriate instrument--a one-year adjustment loan--to achieve difficult and far-reaching objectives; (2) conditionality that was inadequate to achieve the stated objectives. The objectives of the Economic Management and Growth Credit (EMGC) might have been more appropriate if limited to taking initial reform steps and laying a foundation for more fundamental, politically-difficult reforms to follow.*

This shortcoming is explicitly recognized in the first ICR lesson (p. 19). The limited scope of the operation's conditionality is especially puzzling since, as the ICR points out (p. 4), the Bank has been working on reform in most of the EMGC sectors for nearly a decade (e.g., Fiscal Sustainability Credit, Public Service Capacity Building Project, Financial Sector Assessment).

In considering project design, the ICR states that the EMGC team paid particular attention to the 2002 IEG CAE recommendation that there be a clear link between the objectives and the conditions in adjustment lending. As noted in the previous paragraphs, this was largely not done.

*This seems to be recognized in the conditionality matrix (PD, p. 43) where it states that for one of the actions taken to improve financial sector performance, "This is a precursor to future work on building a credit culture to contribute to a better functioning of the financial system." However, as stated in the PD, the limited actions in this area were intended to *achieve* the objective of improving financial sector performance.

4. Achievement of Objectives (Efficacy) :

Overall efficacy was *modest*: substantial for objective 1, modest for objectives 2 and 3, and negligible for objective 4. In considering efficacy, it should be noted that the ICR itself rated achievement of objective 1 as *satisfactory* and of objectives 2, 3 and 4 as *moderately satisfactory*.

1. Strengthen the macroeconomic environment: Achievement was *substantial,* with very good macro performance in 2004-2005, although much of the progress could be attributed to the steep rise in copper prices and the dynamism of that sector. In this context, it should be noted that government revenue (excluding grants) as a percentage of GDP declined from 18.2 percent in 2004 to 17.4 percent in 2005 and a projected 16.8 percent in 2006 (IMF 4th Review, July 2006, p. 20)--a worrisome trend noted by the Fund.

2. Improve financial sector performance: Achievement was *modest*. Despite the decline in government borrowing and the expectation that private borrowing would increase, the ICR does not present evidence that this occurred. Credit to the private sector remained at around 8 percent of GDP during the EMGC, and "only large corporations

and a few SMEs had access to credit in 2006....in 2005, the banking system continued to be small and under-developed." (Martinez, "Access to Financial Services in Zambia," World Bank Policy Research Working Paper 4061, November 2006)

3. Improve public sector management: Achievement was *modest*. The Government took actions that promise to consolidate management of domestic and foreign debt; improved budget management and enhanced the credibility of the budget process. Parliament passed a revised Finance Act and implementing regulations are being developed. Progress was made on consolidating allowances, and in installing the PMEC system. The ICR, however, does not provide sufficient evidence of meaningful, concrete improvements in public sector management.

4. Improve Zambia's business environment. Achievement was *negligible*, with the ICR presenting insufficient evidence that the business environment improved. The ICR states that progress included a reaffirmation by the Cabinet of its commitment to market-based policies, adoption of a PSD Action Plan, creation of a single (one-stop) Zambian Development Agency, and amending legislation on Export Processing Zones. The Government also adopted Policy Statements for the energy and telecom sectors that are expected to clarify and improve the situation in these areas.

   However, as noted, insufficient evidence is presented that there was actually positive change in the business climate. The Bank's "Doing Business" indicators show that in terms of the ease of doing business, Zambia was ranked 92 out of 175 countries in 2005 and 102 of 195 in 2006, suggesting no progress--or even deterioration--in the business environment. Domestic private investment rose slightly from 15.6 percent of GDP in 2004 to 16.0 percent in 2005 (IMF 4th Review, July 2006, p. 20). Further, the Fund has taken a dim view of progress in this area: "Progress on priority measures under the Private Sector Development Initiative to reduce the cost of doing business--streamlined licensing, labor law reform, and opening the international telecom gateway--has been limited. (Zambia ranks among the highest cost countries for terminating employees.) Instead, the authorities have emphasized adoption of legislation to promote investment by creating a one-stop investment agency and giving incentives to priority sectors." (IMF 4th Review, July 2006, p. 17.)

5. Efficiency :

Efficiency was not considered as this was an adjustment loan.

6. M&E Design, Implementation, & Utilization:

Although the PD states that the conditionality matrix provides "monitorable indicators and expected outcomes from this operation" (para 4, p. 1), M&E design and implementation was poor overall. It was good in the macroeconomic area, with specific, quantitative goals that are cited in the ICR. For the other three areas, however, monitoring indicators are not reflective of progress toward meeting the PDOs. Instead, the PD and ICR seem to equate meeting the project conditions with achievement of the PDOs, and thus apparently regard fulfillment of conditions as indicators of success.

7. Other (Safeguards, Fiduciary, Unintended Impacts--Positive & Negative):

8. Ratings:	ICR	ICR Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Unsatisfactory	There were major shortcomings in relevance (sec 3) and efficacy (sec 4), which is consistent with a rating of unsatisfactory.
Institutional Dev .:	Modest	Modest	
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Unsatisfactory	Quality at Entry was unsatisfactory due to the operation's design flaws (sec 3). Taking into account the expansive objectives, the choice of instrument was poor, and the conditions specified in the operation were insufficient. Lessons of experience were cited, but some were not substantively incorporated into design. Supervision did not remedy the design flaws, and showed insufficient focus on

			development impact.
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Unsatisfactory	

NOTES:
- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

9. Lessons:

- In policy-based lending, the Bank needs to focus to a greater extent on the consistency of project conditions with the objectives being addressed.
- The lending instrument needs to be consistent with the objectives being sought, which was not the case for the EMGC

10. Assessment Recommended? ○ Yes ● No

11. Comments on Quality of ICR:

The ICR is unsatisfactory. The evaluation presents a good deal of useful information on the project, especially in the macroeconomic area. However, it does not present sufficient information to assess the extent to which the project achieved its development objectives. Instead, it takes the point of view that fulfillment of the conditions is tantamount to achievement of the objectives, which is not the case.

For example, in addressing the objective to "advance financial system performance," there are a number of well-established indicators of financial system performance, but the ICR mentions none of these, focusing instead on implementation of planned actions. Similarly, regarding "improve business environment," there are many ways that progress in this area could be measured, but none of these was utilized.

Additionally, the ICR's attribution of progress in strengthening the macroeconomic environment to the EMGC is excessive. In reality, actions taken under the EMGC were less significant than those under the IMF's PRGF program, and the ICR should have been more candid about this.