ICR Review
Operations Evaluation Department

Report Number : ICRR11708

1. Project Data:		Date Posted :	03/11/2004	
PROJ ID:	P073572		Appraisal	Actual
Project Name :	Structural Fiscal Adjustment Loan	Project Costs (US$M)	400	400
Country:	Colombia	Loan/Credit (US$M)	400	400
Sector(s):	Board: EP - Sub-national government administration (32%), Central government administration (26%), Compulsory pension and unemployment insurance (16%), Health (16%), Health insurance (10%)	Cofinancing (US$M)		
L/C Number:	L7092			
		Board Approval (FY)		2
Partners involved :		Closing Date	12/31/2002	03/31/2003

Prepared by :	Reviewed by :	Group Manager :	Group:	
Elliott Hurwitz	Jorge Garcia-Garcia	Kyle Peters	OEDCR	

2. Project Objectives and Components

a. Objectives

The main objective was to provide support to the government's demonstrated commitment to reaching an inflection point in its fiscal accounts path, an essential first step toward achieving full fiscal sustainability, economic growth, and poverty reduction. The program to be supported by the SFAL focused on a core set of policies that could strengthen the country's fiscal outlook. This policy package involved (a) rationalizing the system of transfers to local governments, and imposing more market- driven and more binding budget constraints on their finances; (b) establishing mechanisms to arrest the exploding cost of inefficiency in the provision of public health services; (c) halting the accumulation of pension-related contingent liabilities; (d) advancing the reorganization of public agencies and their current expenditures; and (e) setting up a better system for managing public debt.

b. Components

Macroeconomic Framework

Maintain macroeconomic framework consistent with the objectives of the program.

Intergovernmental Fiscal Relations

1. Passed the constitutional amendment dated July 30, 2001, regarding transfers of resources from the Central Government to Territorial Entities.
2. The government submitted to Congress a draft law reforming the tax system of Territorial Entities to increase subnational tax revenues by more than 20 percent in real terms in the first year of its application term compared to realized tax revenues in 1999. The final law passed by Congress is to be substantially in accord with this draft.
3. Implement the constitutional amendment to limit the rate of growth of: (a) total transfers of resources to Territorial Entities to a rate equivalent to 2001 inflation plus two percentage points; and (b) the operational expenditures of the entities of the Central Government set forth in the law to a rate equivalent to 2001 inflation plus 1.5 percentage points..
4. Promulgate and implement Presidential Decree governing debt and borrowing of Territorial Entities, which (a) limits unsustainable borrowing and constrains the freedom of Territorial Entities in issuing debt; and (b) prohibits Territorial Entities from receiving any bailouts or guarantees of their debt.
5. Draft law No. 086, which rationalizes and reforms the tax system of Territorial Entities, submitted to Congress on September 6, 2001, has become law substantially in accordance with the submitted draft law.

Health Reform

1. The Ministry of Health, Department of National Planning, and Ministry of Finance have defined and approved a national public hospital restructuring policy and implementation program for the next five years, and have begun the implementation, including selection of at least 10 departments. For 2002, implementation has covered more than 15

percent of the total public hospital budget included in the FYOI budget .
2. The Central Government was to sign and start to implement contracts with at least three Territorial Entities to finance restructuring of their hospitals, to include specific annual targets for (a) productivity increases in inpatient and outpatient services and (b) labor cost reductions with a view to achieving fiscal savings equivalent to at least five percent per month on average, in real terms, in relation to the same period in 2001.
3. At least 60 percent of health-related funds of budgetary transfers (after deducting mandatory legal contributions) set forth in the 2001 budget are to be transformed to demand subsidies for health services .

ISS (Social Security Institute) Reform
1. The government has initiated a restructuring plan for ISS Health, including negotiating with unions about labor costs and benefits, and has implemented the first phase, including completion of renegotiating 50 percent or more of ISS's total outstanding debt to health service providers and the reduction in at least 30 percent in the waiting list for elective surgeries (as of June 30, 2001).
2. The Central Government and the ISS have reached an agreement to generate annual savings in ISS's total costs over a ten-year period which would, in the opinion of the Bank, make ISS financially and economically viable .

Pension Reform
1. The government created a new social security department in the Ministry of Finance for improving social security system control. Improved control of public pension regimes has generated fiscal savings equivalent to more than US$100 million in 2001.
2. Better central Government controls of pension payments, including *inter alia*, reduced payments of ineligible pension claims, generate fiscal savings, on average, of at least $ 10,000,000 equivalent per month.
3. (a) Congress to approve a law to reform the general pension system governed by Law No . 100/1993 in order to put this system on a sustainable path, in a manner satisfactory to the Bank; or (b) Congress to approve a law to reform at least one of the pension regimes which are exempted from the rules applicable to the general pension system in a manner that brings the reformed regime or regimes, in the opinion of the Bank, in line with the Borrower's general pension system.

Public Sector Reform

1. The government's approved budget for FY 02 includes a reduction in total central government current expenditure (net of interest payments and transfers to subnational entities and to social security) of more than 4% in real terms in relation to the same expenditures in the approved budget for FYOI .

2. The government's approved budget for FY 02 has included a reduction in central government's general expenditures of more than 15% in real terms in relation to the same expenditures in the FY 00 executed budget.

3. The Central Government's total actual current expenditures (net of interest payments and transfers to Territorial Entities and to social security) incurred in 2002 are to generate average savings of more than 4% in real terms in relation to the same expenditures incurred during the same period in 2001.

4. The budget approved for 2002 is to include general expenditures that in real terms are not higher than those effectively incurred under the executed budget for 2001.

Education

(a) Law No. 60 (1993) to be amended to provide for certification of municipalities that, together with districts, represent at least 40 percent of the country's school enrollment enabling such municipalities to autonomously manage provision of education services (including teacher payroll) and establish education performance monitoring mechanisms; or (b) the Central Government to certify municipalities that, together with districts, represent at least 14 percent of the country's school enrollment enabling such municipalities to autonomously manage provision of education services (including teacher payroll), and satisfactory performance agreements have been entered into between the Central Government and such certified districts and municipalities . In either case, no extra budgetary transfers for education to such certified districts or municipalities shall have taken place .

c. Comments on Project Cost, Financing and Dates
The second tranche was released 7 months later than planned, due to an overly-optimistic schedule and delays that occurred during an election year.

3. Achievement of Relevant Objectives:
Macroeconomic performance --Macroeconomic performance was *satisfactory*. GDP grew during 2002-2003 and inflation generally declined. The fiscal deficit grew in 2002, contrary to the program's objectives, but then fell in 2003.

Intergovernmental Fiscal Relations --Achievement was *satisfactory*.
(1) Intergovernmental transfers complied with the limits specified in the constitutional amendment (see section 2).

(2) Issuance of debt by Territorial Entities was restricted (see section 4).
(3) Law 788-2002 was passed, which contained most of the intended reforms (see section 5).

Health Reform --Achievement was *satisfactory*.
(1) The government implemented a National Hospital Restructuring Policy, and the pilot phase (2002) covered more than 10 departments and 15% of the total hospital budget.
(2) The government signed contracts with six Territorial Entities for restructuring hospitals.
(3) More than 60% of the budgetary transfers were transformed into demand subsidies.

ISS (Social Security Institute) Reform--Achievement was *unsatisfactory*.
While the government began implementation of a restructuring plan, it was not assessed by the Bank as adequate (see section 5).

Pension Reform --Achievement was *satisfactory*.
(1) The Government brought public pension schemes under the operational control of a single entity, DRESS.
(2) Tighter administration and stricter management of eligibility generated fiscal savings of over US$ 100 million per year.
(3) Congress passed a law in December, 2002, which brought an exempted pension scheme under the control of the general pension system.

Public Sector Reform --Achievement in this area was *unsatisfactory*.
(1) The approved 2002 budget for total central government current expenditures complied with the requirement to be 4% below the previous year in real terms.
(2) However, for 2002, actual real government expenditures rose by 4%, 8 percentage points above what was intended.

Education --Achievement in this area was *satisfactory.*
Law 715 was passed in 2001 which provided for certification of municipalities (comprising more than 40% of the country's school enrollment) to autonomously manage their school systems, and also established performance monitoring systems.

4. Significant Outcomes/Impacts:

- Decree No. 2540 was adopted specifying that banks holding the debt of sub-national entities are subject to risk-weighting based on the ratings of this debt by an internationally reputable credit rating agency. New banking regulations also specify that financial firms may only hold the debt of subnational entities which have received investment-grade ratings from 2 reputable rating agencies.
- Passage of a constitutional amendment and new law on intergovernmental fiscal relations has substantial promise to achieve fiscal benefits

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

- While the government complied with loan commitments to reduce central government and general expenditure <u>budgetary commitments</u> (2002 over 2001) by 4%, <u>actual expenditures</u> rose by 4%, or 8 percentage points above what was intended
- Government actions to restructure the ISS were not sufficient to put the agency on a financially viable course
- Law 788-2002, which governs the subnational tax scheme, did not contain all of the elements specified in the conditionality, and a waiver was required for release of the floating tranche

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	The country's structural improvements across a number of SFAL areas acted to reduce the fiscal deficit. However, the country's failure to achieve the goal of reducing the actual 2002 fiscal deficit, and in achieving ISS reform detracted from the benefits achieved in other areas.
Institutional Dev.:	Modest	Modest	
Sustainability:	Likely	Non-evaluable	Government commitment to fiscal reform was inconsistent, strong in some respects but weak in others (e.g., by exceeding project spending limits in budget execution while at the same time implementing additional tax measures).

Bank Performance :	Satisfactory	Satisfactory	While Bank performance was overall satisfactory, the use of a quick disbursing adjustment loan was unwise in this instance (see section 7).
Borrower Perf .:	Satisfactory	Satisfactory	While Borrower performance was overall satisfactory, actual 2002 expenditures exceeded project provisions.
Quality of ICR :		Unsatisfactory	

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

7. Lessons of Broad Applicability:

- **In a project designed to reduce the fiscal deficit, conditions should be set in terms of actual expenditures rather than budgetary allocations** --In the SFAL, after tranche release actual expenditures accelerated, violating the intent of the conditionality.
- **A series of one -tranche programmatic loans utilizing executed budget data would have been more effective** --A series of programmatic loans (which are in actuality following the SFAL) would have been more effective than a short quick-disbursing loan in achieving structural reform and reductions in actual budgetary spending .

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:

The ICR is unsatisfactory:

- The ICR presents insufficient data to substantiate its rating of macroeconomic performance, and some of the data presented are incomplete or misleading. A competent presentation of data on macroeconomic performance is particularly important in an evaluation of a fiscal structural adjustment project . The ICR should have presented, at a minimum, actual data from 1999 through 2002 on real GDP growth, inflation, the fiscal balance, and public debt as a % of GDP.
- The ICR statement of the project objectives does not correspond to the RRP or other key project documents .
- The ICR rates achievement of Component 6, Public Sector Reform, as marginally satisfactory. The analysis presented to substantiate the ratings of this aspect of the loan is deficient .
- While in many cases the ICR provides information on the achievement of structural reforms, often the information is not sufficiently specific to make evaluative judgments, e .g., "specific measures implemented included renegotiating special-benefit agreements with labor unions, restructuring the ISS debt, improving its financial management, eliminating 8,000 vacant positions, and closing ambulatory health facilities ." Also, the ICR presents little data on outcomes, showing the effects of the reforms .
- The ICR description of progress in the area of pension reform is unsatisfactory . For example, the ICR also does not state whether a unified registry of contributors has been established .
- Annexes 2 and 4b (on project costs and financing) were not completed.