ICR Review
Operations Evaluation Department

Report Number : ICRR11069

1. Project Data:		Date Posted :	10/31/2001	
PROJ ID:	P066153		Appraisal	Actual
Project Name :	Programmatic Structural Adjustment Loan I	Project Costs (US$M)	40.41	40.41
Country:	Latvia	Loan/Credit (US$M)	40.41	40.41
Sector(s):	Board: PS - Central government administration (47%), General industry and trade sector (35%), General finance sector (6%), General energy sector (6%), General transportation sector (6%)	Cofinancing (US$M)	0	0
L/C Number:	L7007			
		Board Approval (FY)		00
Partners involved :		Closing Date	12/31/2000	12/31/2000

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2. Project Objectives and Components

a. Objectives

Improve governance by strengthening public accountability, improving the efficiency and effectiveness of public sector operations, and raising the transparency of the Latvian state's interactions with the private sector, including civil society. This is the first of three envisaged loans, using the programmatic loan as the framework for lending .

b. Components

(a) Correcting macroimbalances
(i) Correcting macroimbalances that emerged after the Russia crisis
(ii) Ensuring the financial viability of the pension system
(b) Strengthening the credibility of the public sector
(i) Reducing risks and opportunities for corruption in government and in the judiciary
(ii) Strengthen transparency and reporting of the ministries and bodies subordinated, supervised or managed by government and by the judiciary
(c) Improving the institutional capacity to deliver public services
(i) Streamlining the structure of the public sector and increasing its administrative efficiency and transparency
(ii) Strengthen human resource management by improving incentives for recruitment and retention of high quality staff
(iii) Improving public expenditure management
(d) Rationalizing a transparent relationship with the private sector
(i) Privatizing five remaining commercial state firms and develop and announce governance structures and regulatory regimes
(ii) Energy sector regulation and privatization
(iii) Telecommunications sector privatization and regulation
(iv) Achievement of a uniform approach to supervision of financial markets and strengthening of financial supervision system, especially for non-bank financial institutions
(v) Strengthening legal and regulatory processes to improve efficiency of regulation and to reduce costs of abuse of regulatory power by public institutions

c. Comments on Project Cost, Financing and Dates

No major changes were made. This is an adjustment operation. This loan was a one tranche operation where funds were disbursed at effectiveness.

3. Achievement of Relevant Objectives:

(a) Correcting macroimbalances.
(i) Most benchmarks were met under the concomitant IMF Standby Arrangement. But the external current account deficit declined from just below 10 percent in 1999 to 7 percent in 2000. The fiscal deficit reached 3.2 percent in 2000, but exceeded the IMF target of 1.9 percent set in the Standby. Domestic investment and national savings growth recovered in 2000. Overall growth improved from 1 per cent in 1999 to 6.6 percent in 2000.
(ii) Benchmarks for the pension reform were met.
The Parliament passed legislation to adopt a second tier, the establishment of individual pension accounts, and the implementing ministries have met loan benchmarks.

(b) Strengthening the credibility of the public sector.
(i) Anti-corruption measures. The Government did not fulfill its agreement to establish a strong mechanism to monitor and to report on corruption. After much delay, procedures were developed to identify conflicts of interest for high level executive and legislative branch officials. Progress has been slow in drafting manuals to train public sector employees on conflicts of interest and illicit enrichment.
(ii) In the judiciary, assignment of judges to cases on an impartial basis has improved and the Ministry of Justice has issued instructions on ex parte communications between judges and litigants. All court decisions are not yet electronically published.
(iii) Some improvements in the legislative framework for public sector agency operation have occurred. The Law on Public Sector Agencies was passed by Parliament, but the Administrative Framework Law is now being integrated with another Law on Executive Powers which has been submitted to Parliament.
(c) Improving institutional capacity to deliver public services
(i) Government had agreed to prepare a program and action plan to implement reform of the public administration. A blueprint was prepared, but did not contain a timetable or actions. Thus the required reporting to Cabinet of the changes in public sector management and performance has not occurred.
(ii) Strengthen human resource management
As a Board presentation condition, the Cabinet of Ministers adopted the concept of a broad banded, transparent, uniform pay-scale for the public sector. The Law on Civil Service was adopted by Parliament. However, the survey of the existing pay structure has not been executed.
(iii) Improving public expenditure management.
As Board presentation conditions, all accounts of budget-financed operations have been brought into the budget. Also, all state-budgeted institutions are to submit annual audited reports to the State Treasury as of 2001. The recommendation to Parliament to establish a Public Accounts committee has not been implemented. For development of performance-oriented budgets, a draft fiscal strategy document is now being discussed in the Cabinet. The Cabinet will review new policy proposals from ministries. The Cabinet has agreed to discuss and disseminate a medium term fiscal framework, leading to a medium term budget. Work has begun on developing integrated financial and reporting procedures for local government. A pilot to implement and to test the introduction of social assistance benefits targeted at the poorest households is in progress. The Cabinet adopted an implementation plan to introduce a national benefit targeted at the poorest households.
(d) Rationalizing a transparent relationship with the private sector
(i) The objective of privatizing the five large commercial state firms was not achieved. (ii) The energy company was not privatized. A law was passed to create a Public Services Regulatory Council which will produce energy sector regulation. (iii) The telecommunications privatization is in arbitration with the assumed buyer of the company. A telecommunications law has been submitted to Parliament.
(iv) More has been achieved in strengthening financial sector supervision. A Law on a Unified Financial Supervision Agency was passed by Parliament.
(v) Improving the efficiency of regulation and reducing costs of abuse of public sector regulatory power. The Secretariat of the Ministry of Public Service Reform and the Cabinet have adopted new rules for inspection of ministries. A council of inspectorates has been established to implement the reform program.

4. Significant Outcomes/Impacts:

(a) Correcting macroimbalances. GDP growth improved from 1 percent in 1999 to 6.6 percent in 2000. Parliament passed a law creating a second tier for the pension system.
(b) Strengthening public sector credibility. The Law on Public Sector Agencies was passed. The Law on the Institutional Framework for Public Administration was submitted to Parliament. Annual declarations of potential conflict of interest are now required of high level Government and parliamentary officials. A system for monitoring implementation of the Law on Openness of Information was designed. The Cabinet adopted regulations requiring issuance of annual reports by public sector institutions requiring improved disclosure of information.
(c) Improving institutional capacity to deliver public services. A new civil service law was passed. Cabinet has adopted concept of a broad-banded, transparent uniform pay scale for the public sector which rewards merit and minimizes ad hoc bonuses. Parliament passed amendments to the Law on Budget and Financial Management bringing all accounts of budget-financed institutions under the budget. All state institutions must now submit annual audited reports to the Treasury.
(d) Rationalizing a transparent relationship with the private sector. A Law on Public Service Regulators was adopted by Parliament. A Law on Unified Financial Supervision Agency passed by Parliament.

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

At the completion of the ICR, the following shortcomings were noted.

Macroeconomic imbalances were partially corrected under the IMF Standby agreement, although imbalances remain in the external current account and in the fiscal deficit. A second Standby arrangement has been signed with the IMF.

The Programmatic Adjustment Loan approach to public sector reform in Latvia was probably the correct approach given the large number of fundamental changes required in the Latvian public administration, but too many objectives were loaded into the first year of a three year program. The multiyear flexibility of the instrument was not fully used, which is a design flaw. At least a five year implementation period would have been more realistic. An illustration of this phenomenon is that while important preliminary measures were taken, like the passage of laws or the creation of agencies, it proved impossible to effect the follow-on institutional development or implementation steps which were promised.

Government capacity and ability to build political consensus both in the Parliament and in the electorate appears to have been badly overstretched due to the number and complexity of objectives loaded into year one of the program.

No technical assistance appears to have been provided to the Government to implement this complicated program; 101 difficult actions were to have been completed in year one of the program, including passage of Laws, revision of regulatory agencies and frameworks, censuses, and reorganizations. Of the total actions promised, 28, of varying degrees of importance, were accomplished. This suggests that technical assistance would have been helpful. A purely numerical comparison of goals versus achievements does not take into account the varying importance of goals and achievements, but the Government experienced significant policy and institutional setbacks in all components.

Both the anti-corruption and the privatization components suffered major delays. It appears that both the Government and the Bank overestimated the degree of public consensus supporting privatization of the energy and telecommunications companies.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	The project is rated satisfactory, however, it should be noted that the design of this project is overambitious. Had project design better taken into account both the complexity of the objectives to be achieved and the government's capacity, and programmed loan actions to be achieved in accordance with these two parameters, a more realistic set of targets would have resulted.
Institutional Dev.:	Substantial	Substantial	
Sustainability:	Likely	Likely	
Bank Performance:	Satisfactory	Satisfactory	The satisfactory rating is retained because of the quality of the project's objectives, but there was a significant weakness which was the overloading of the loan with too many actions to be taken in a one year framework. This was an unrealistic timeframe, even for an experienced borrower. Additionally, very little conditionality was included in the Loan Agreement on institutional development goals to be accomplished during implementation.
Borrower Perf.:	Satisfactory	Satisfactory	The Government is an experienced borrower, and it made significant program progress. However, it agreed to an unrealistic number of actions to be taken during the first year of program implementation. What it accomplished is

			reasonable in one year. What is not clear is why it agreed to so many difficult activities to be accomplished in such a short timeframe.
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:

Overambitious loan goals to be accomplished in a short time led to unnecessarily high expectations on the part of the Government and the Bank. Lack of goal attainment leads to criticism of the Government and the Bank which would not have been necessary except for overambitious goal definition during loan design .

When Governments undertake medium term complex institutional transformation, they need technical assistance during implementation, not only during design.

When undertaking controversial goals like the privatization of utilities, adequate time has to be programmed to deal with unexpected delays and to build adequate political consensus .

8. Assessment Recommended? ● Yes ○ No

Why? This is one of the first programmatic PSALs done by the Bank . A review of the use of the new instrument is warranted. Furthermore, despite having a quality enhancement review, it is a very complicated operation which significantly overestimated Government capacity to achieve first year goals . This is particularly striking since Latvia is a strong performer along many economic management dimensions and has maintained a stable and positive dialogue with the Bank. The operation also benefitted from high continuity in the country team and from previous lending and analytical work. Thus, the circumstances which led to the overestimate of country capacity need investigation.

9. Comments on Quality of ICR:

While well written, the ICR does not discuss a number of issues which are pertinent to evaluating the design and implementation of this loan. There is a disconnect between Bank staffs' extensive knowledge of the project and the institutional development goals set for the first year of program implementation and Government capacity . The ICR does not explain why was the program so front-loaded with difficult institutional targets? The report is also not very clear on what was and was not implemented after Board presentation . Why was there little conditionality on institutional goals? Finally, the report would have been stronger if it had included a table showing how the Government's main macroeconomic indicators changed over the course of the program . It should also be noted that the Government's ICR contains more information than does the Bank ICR . It would have been helpful if the Bank's section of the ICR had cross-referenced the relevant items in the Government's submission .