

Past as Prologue: OED Assessment of World Bank Reform Progress in Laos

Weak Public Management Performance and Implications for Nam Theun 2

One of the main issues surrounding World Bank support for the Nam Theun 2 hydropower project in Laos is revenue management; namely, whether or not revenues from the proposed project would be used transparently to benefit the poor. As part of its “decision framework” for Nam Theun 2, the World Bank indicates: “a *sine qua non* for Bank support to the project is an agreement upfront on a set of policy and institutional reforms and demonstrated progress on the implementation of these reforms.” The World Bank’s May 2004 *Lao PDR’s Economic Monitor* notes “if future increases in revenue from mining and hydropower are to be used for improving social outcomes instead of financing losses of [state-owned banks] and [state-enterprises], improvements in the use of public resources will be critical” (p. 6).

A June 2004 review¹ by the Bank’s Operations Evaluations Department (OED) examines the performance of the Lao government (GOL) and the World Bank in implementing certain macroeconomic reforms from 1993 to 2003. The evaluation considers specifically the outcome of the 1992 Second Structural Adjustment Credit (SAC2) and the progress achieved in sustaining or furthering SAC2 reforms. These reforms include components critical to the Bank’s Nam Theun 2 project appraisal framework, such as revenue management, budget discipline and transparency, and administrative capacity building. The OED review notes that SAC2 reforms were not sustained or enforced after the closure of the SAC2 program and as a result, these measures had to be reintroduced in subsequent Bank operations during the 1993-2003 period, including in the recent Financial Management Adjustment Credit (FMAC).

The 2004 OED re-assessment of SAC2 rates both World Bank and GOL performance “unsatisfactory” for the overall period, and downgrades the program’s rating to “moderately unsatisfactory”:

Although reform implementation has improved recently, there has been a general lack of progress in most areas during most of the period since SAC2 close. This lack of progress is reflected in the assessment of the 2002 Public Expenditure Review and in a number of reforms that were repeated in subsequent operations, most notably the Financial Management Assistance [sic] Credit (FMAC). The sustainability rating is changed from likely to unlikely. The sustainability of SAC2 is now a matter of record, and it is clear that a reasonable rate of reform progress was not sustained in most areas. (p. iii)

The Bank has relied too heavily on lack of implementation capacity as an explanation for failure to implement reforms. The earmarks of weak capacity may be evident.... However, the main weakness in the SAC2-supported areas of revenue mobilization, publishing the budget, instituting cost recovery tariffs, public expenditure management and strategic privatizations seem to have much more to do with weak commitment to reform at the level of the true policy-makers than with implementation capacity. (p. 13)

While the GOL has taken recent actions to meet World Bank structural reform conditions in the lead-up to the Bank’s Nam Theun 2 decision, the overall track record is overwhelmingly negative. Additionally, the Bank was not successful in cultivating borrower ownership or ensuring that reforms were maintained during the 1990s. Without a sustained commitment to reform over a period of time and demonstrated ability to manage revenues transparently for poverty reduction, there is no justification for World Bank support for Nam Theun 2.

¹ World Bank Operations Evaluations Department, “Project Performance Re-Assessment Report, Lao PDR, Second Structural Adjustment Credit,” June 24, 2004.

Excerpts from OED's "Project Performance Re-Assessment Report, Lao PDR, Second Structural Adjustment Credit" June 24, 2004

The objective of the second Structural Adjustment Credit (SAC2) was to support the consolidation of comprehensive reforms...in the areas of (i) enterprise reform, focusing on privatization and private sector development; (ii) resource mobilization, through revenue enhancing policy measures and administrative capacity building; and (iii) public resource management upgrading, by developing a healthy public investment program, a budget management administration more capable of enforcing budget discipline and conducting short-term fiscal policy, a more compact and cost-effective administration and a reduced, but motivated civil service. (p. iii)

...Bank performance is rated satisfactory, although with major weaknesses, through the close of SAC2, but unsatisfactory through the continuation of the reform program to the present. **The Bank was not effective in cultivating borrower ownership, nor did it take adequately into account the government's concerns about the openness the reforms would require. In the end, the Bank had to re-visit much of the conditionality of SAC2 in a subsequent operation (FMAC). Borrower performance is downgraded from satisfactory at the close of SAC2 to unsatisfactory subsequently, mainly because of minimal commitment to implementing in a meaningful way the reforms in civil service, public resource management and resource mobilization, the core of the SAC2 program...** (p. iii)

Outcome

... [The] continuation [of the program] is critical to a satisfactory rating because SAC2 encompassed mainly intermediate measures, such as the submission of laws, drafting of guidelines and plans, and adopting programs. The real development impact of these measures would be realized only if the next steps of implementation and enforcement were to take place. By any reasonable standard, the 10-year perspective offers sufficient time for these next steps to occur. (p. 5)

Outcome by Objective/Component

Budget discipline did not improve significantly, as expenditures exceeded revenues by wide margins throughout the 1990s and beyond. For transparency, the detailed budget was also to be published on an annual basis, but that practice ceased and was only recently resumed. The GOL did approve a five-year investment plan, which proved a very challenging condition to fulfill, mainly over agreement on its composition. Subsequent investment planning exercises, such as were part of the early IPRSP process eight years later, **revealed that investment planning capacity had not significantly progressed. Basic principles, such as developing a public investment plan within a realistic resource envelope, were not adhered to.** (p. 8)

Institutional Development Impact

The 1995 OED assessment rated institutional development impact (IDI) modest. The subsequent eight years of experience in Lao PDR demonstrated a continued weak IDI, which is rated modest.... **Major evidence of the general lack of institutional progress in the SAC2 reform areas is the fact that many of the SAC2 objectives were re-introduced 10 years later in the FMAC that became effective in June 2002. ... Measures dealing with budget control and transparency in SAC2, for example, reappear in the PER (2002) as the need for a basic framework for accounting and auditing and for effective expenditure controls, which indicates that the efforts toward budget control neither advanced very far nor led to the expected outcomes.** (p. 11)

The record on public resource mobilization and management is weak. The GOL published only a very brief bottom line statement of the budget, allowing no public scrutiny of detailed revenues and expenditures, and stopped publishing the budget altogether after 1993. Only very recently (July 2002) has the GOL published a detailed budget. Measures to increase revenues have not been institutionalized, and the Large Taxpayer Units are not functioning well. (p. 11)

Sustainability

... To stimulate development in the rural areas, the GOL invested a large amount of resources, far more than they could afford, in the agriculture sector, specifically irrigation. The GOL aimed to increase irrigated rice production by expanding area cultivated from 22,000 ha to 100,000 ha. Large sums were invested in irrigation pumps and civil works to expand area harvested. To pay for the investments, the GOL printed money and borrowed heavily from the Central Bank. In the short-run (1999-2000), the investment did result in a large increase in dry season rice production. Soon however, maintenance costs, which had not been budgeted, soared. ...**Clearly, earlier lessons of macroeconomic stability had not been learned, and stability proved not to be as sustainable as asserted in the first OED assessment.** (p. 12)

A chronic issue for Lao PDR is the adequacy of skills with which to implement reforms and programs. The 1995 OED assessment cited the Bank's overestimate of GOL's implementation capacity as a decisive flaw in the design and preparation of SAC2. Country assistance strategies and PERs have subsequently and continually pointed to weak implementation capacity as a reason why projects fail to meet expectations. Yet there are continuous TA projects. **Year after year, donors invest in capacity building, with little sustained improvement in implementation. Most recently, the Bank has funded a substantial TA project to support the reforms under FMAC.** (p. 13)

The Bank has relied too heavily on lack of implementation capacity as an explanation for failure to implement reforms. **The earmarks of weak capacity may be evident, such as poor inter-ministerial coordination, weak databases and monitoring. However, the main weakness in the SAC2-supported areas of revenue mobilization, publishing the budget, instituting cost recovery tariffs, public expenditure management and strategic privatizations seem to have much more to do with weak commitment to reform at the level of the true policy-makers than with implementation capacity.** (p. 13)

Bank and Borrower Performance

The Bank seized the opportunity to play an important role in the Lao PDR reform program, but did not adjust well when the reform momentum waned. (p. 14)

At the time of SAC2 effectiveness, the GOL's heightened concerns about economic openness and control were evident. **The Bank should have taken more into account these concerns that led to the reform stagnation and, in some cases, reversals. As a result, the Bank did not catalyze much change in most areas of SAC2, including mobilizing public resources, reforming the civil service, or improving the budgeting process. The Bank also proceeded with the program without sufficient coordination between the ministries. Monitoring and evaluation remain weak.** (p. 14)

The lack of reform progress became particularly evident when the FMAC and the PER for 2002 covered much of the same ground as did SAC2. **The Bank might have made more explicit reference (in the Bank's appraisal for FMAC) to the fact that Lao PDR had not progressed reasonably between SAC2 and the FMAC, and then translated this finding into risk mitigation measures for FMAC.** In conclusion, while Bank performance was satisfactory through the completion of tranche conditions and has improved in the past couple of years, Bank performance is rated unsatisfactory for the overall period. (p. 14-15)

Borrower performance was arguably satisfactory during the project life, but was also on a downward trend, and was mainly unsatisfactory in the public management and resource mobilization areas of SAC2 throughout the rest of the 1990s. The GOL failed to maintain a stable macroeconomic framework after SAC3 close/cancellation, to reform or reduce the size of the civil service, or to introduce sufficient measures to improve revenue mobilization. Reform commitment faltered and coordination between ministries was lacking. ... Although, like Bank performance, Borrower performance has improved in the last two years, Borrower performance is rated unsatisfactory overall. (p. 15)

Conclusions and Lessons

... In the past couple of years, GOL has been trying to make up for lost time. Still, institutional development and policy-making have lagged far behind where they could reasonably expect to be, given the agenda pursued under SAC2 more than 10 years ago.