ICR Review
Operations Evaluation Department

Report Number : ICRR10223

1. Project Data :	
OEDID:	L3819
Project ID :	P036055
Project Name :	Structural Adjustment Loan
Country:	Ecuador
Sector:	Public Sector Management Adjustment
L/C Number:	L3819
Partners involved :	None
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2. Project Objectives, Financing, Costs and Components :

Objectives : Consolidate macroeconomic stability; implement public sector reforms; support privatization; and provide a set-aside for the DDSR agreement reached between Ecuador and its commercial bank creditors . **Components** : liberalization of domestic petroleum derivative prices; strengthening of the sanctions for tax non-compliance; reductions in public sector employment and a restructuring of major agencies; implementation of a modern budget process; and support for the transfer, through privatization or long -term concession, of the state telephone and power companies, and assorted non -strategic public companies. **Costs and financing** : The total project costs were US$100 million (US$200 million at appraisal), all of which was financed by the Bank. Disbursement was in three tranches. The project was approved in FY95, and closed with a four-month delay in FY98, after cancellation of the US$100 million third tranche.

3. Achievement of Relevant Objectives :

The project fully achieved only one of its four main objectives . A DDSR agreement was completed in 1995 with the help of a US$50 million set-aside which was provided by the first tranche of the SAL . Unfortunately, a series of exogenous shocks, including damage from El Nino, the collapse of oil export prices, a severe drought and a border conflict with Peru, together with severe internal political turmoil, have led to an unraveling of the macroeconomic situation since late 1995 and a return to deep external indebtedness . Petroleum prices were adjusted according to a market-based formula from 1994 to January 1997, briefly abrogated in 1997, and then adjusted by a new formula since January 1998 which has so far maintained near-parity with international prices. Sanctions for tax non-compliance were adopted, then discontinued, allegedly because the tax authorities had better methods to achieve this goal. The fact remains that, despite a mild improvement in tax collections during the SAL implementation period, the quality of tax administration and enforcement remains well below Latin American norms . The number of civil servants was reduced by 5 percent during the Duran Ballen Administration, but increased in subsequent Administrations, with a negative impact on fiscal sustainability . Restructuring of public agencies was not carried out, although a new Administration (August 1998) is attempting to do so. Similarly, a modern budgetary process remained largely on paper, until quite recently (i.e., after the SAL had closed). The state telephone company was brought to auction, but was never sold because there were no bidders . It has been split in two, but remains in the public sector. The power company was also not privatized.

4. Significant Achievements :

The SAL helped facilitate the DDSR agreement of 1995, which reduced the burden of external commercial bank debt by 40 percent; broke the stalemate over domestic petroleum derivative prices, which had been heavily subsidized, and promoted a wide-ranging dialogue on structural reform which has advanced the plans of the current Administration and possibly built wider public support.

5. Significant Shortcomings :

The SAL overloaded conditionality on the third tranche, rather than requiring up -front, hard-to-reverse reforms before disbursing; it made inadequate provision for the risks of political instability, popular resistance to reform, and destabilizing external shocks, even though these issues had been well -understood for more than a decade prior to SAL identification; and it represented a short-term instrument ideal for meeting one major short-term objective

(DDSR), but unsuitable for supporting the other objectives, which were complex and long -term in nature, like public sector reorganization.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Unsatisfactory	Support of a successful DDSR and promotion of a reform dialogue are not enough to justify this loan. Neither the major structural reforms, nor stabilization of the economy, was achieved.
Institutional Dev .:	Partial	Negligible	It isn't enough to pass laws; they have to be implemented, and, with one or two exceptions, this did not happen, notably in the promised reorganization of the public sector and the privatization of two parastatals..
Sustainability:	Unlikely	Unlikely	
Bank Performance :	Satisfactory	Satisfactory	The Bank misjudged the Executive's capacity to overcome popular resistance to reforms, designed a SAL which was excessively complex, contained insufficient up-front conditionality, and failed to hedge adequately against risks which were readily foreseeable. The privatization process proposed for the power company was technically deficient; the Bank was slow to acknowledge that the loan was troubled, and was slow to adopt the only practical remedy -- cancellation. Offsetting this were: the Bank's reasonable desire to support an Administration which had a two-year track record of strong macroeconomic stabilization and encouraging signs of commitment to broad structural reform; the importance of supporting DDSR, which would probably not have worked without a quick-disbursing tranche from the SAL or some similar instrument; and the decision to backload the largest tranche, in recognition of the risks that the Borrower would not comply with the key conditionalities. In the end, the Bank quite properly cancelled the third tranche, and probably should have cancelled the second as well. All in all, this is a "marginally satisfactory" Bank performance.
Borrower Perf .:	Deficient	Unsatisfactory	
Quality of ICR:		Unsatisfactory	

7. Lessons of Broad Applicability :
SALs are inappropriate instruments for the support of complex, long -term policy and institutional reforms.

8. Audit Recommended? ○ Yes ● No

9. Comments on Quality of ICR :
The ICR provides extensive discussion of the multitudinous reform objectives of the SAL, the degree of compliance with SAL conditionality, and the rationale for cancellation, supported by adequate statistical and other tables . It lacks an aide memoire and a plan of future operation, but these are largely irrelevant, since the third tranche was

cancelled and the loan terminated without success in any area but the DDSR . Its major shortcomings are the inconsistencies between the evidence of project failure, which is obvious and convincing, and the ratings judgments on outcome, ID, and Bank performance which are unaccountably positive . For this reason, more than any other, the ICR was rated unsatisfactory.