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CARIBBEAN DEVELOPMENT BANK

EXECUTIVE SUMMARY WITH MANAGEMENT RESPONSE

PROJECT COMPLETION VALIDATION REPORT

POLICY-BASED LOAN
ST. KITTS AND NEVIS

OFFICE OF INDEPENDENT EVALUATION

MARCH 2016

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EXECUTIVE SUMMARY

1. BASIC PROJECT DATA

Project Title:	Policy-Based Loan - St. Kitts and Nevis
Country:	St. Kitts and Nevis (SKN)
Sector:	Multi Sector
Loan No.:	19/SFR-OR-SKN
Borrower:	Government of St. Kitts and Nevis (GOSKN)
Implementing/Executing Agency:	Ministry of Finance, Sustainable Development, Information and Technology

Disbursements ($mn)	**CARIBBEAN DEVELPPMENT BANK LOAN (USD mn)**		
	OCR	**SFR**	**Total**
Loan Amount	12.0	8.0	20.0
Total Loan Disbursed	12.0	8.0	20.0
Cancelled	-	-	-

Project Milestones	**At Appraisal**	**Actual**	**Variance (months)**
Board Approval	2006-12-14	2006-12-14	-
Loan Agreement signed	2007-05-27	2007-05-24	0.33
Loan Effectiveness[1]	2007-06-30	2008-05-09	9.50

CDB Loan	**At Appraisal**	**Actual**	**Variance (months)**
First Disbursement Date	2007-06-30	2008-07-08	12.26
Terminal Disbursement Date (TDD)	2008-06-30	2010-09-20	26.67
TDD Extensions (number)	-	2	-

Project Cost & Financing ($mn)	**At Appraisal**	**Actual**	**Variance**
CDB Loan	20.00	20.00	-
CDB Grant	-	-	-
Counterpart (GOB)	-	-	-
Total	20.00	20.00	-

Terms	**Interest Rate**	**Repayment**	**Grace Period**
CDB Loan (SFR)	2.5 (Fixed)	25 years (including grace period)	5 years
CDB Loan (OCR)	6.25 (variable)[2]	20 years (including grace period)	5 years

Implementation	**At Appraisal**	**Actual**	**Variance**
Start Date[3]	2007-06-30	2008-05-09	(10.03) months
Completion Date	2008-06-30	2010-09-20	(26.67) months
Implementation Period	0.95 years	2.36 years	(1.41) years

Economic Rate of Return (%)

At Appraisal Not Applicable

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1 The date the conditions for the first disbursement was satisfied.

2 Pursuant to the establishment of the Interest Subsidisation Fund, (Paper BD75/06 Rev.1, February 28, 2007 refers), a 2% interest rate subsidy will be applied to the OCR rate.

3 Implementation begins with satisfaction of conditions precedent

2. POLICY-BASED LOAN DESCRIPTION

2.01 At the time of project appraisal, the level of public indebtedness in SKN was high by international standards and significantly above the prudential limit of 60% of GDP as suggested by the Monetary Council of the Eastern Caribbean Currency Union (ECCU). Similarly, debt servicing ranked highest among members of the ECCU and exceeded the GOSKN combined spending on health and education. The difficult debt situation posed a real threat to the success of the country's fiscal adjustment programme in maintaining macroeconomic stability and growth prospects for St. Kitts and Nevis. The constraints on policy flexibility and the fiscal vulnerabilities stemmed from St. Kitts and Nevis' susceptibility to external shocks and its high levels of public indebtedness.

2.02 GOSKN acknowledged the importance of improving its debt dynamics as a necessary condition for sustaining economic growth, improving fiscal performance and protecting past social gains. The closure of the sugar industry, while providing an opportunity to enhance the country's growth potential by reorienting sugar industry resources to more productive uses, presented substantial short-term social and fiscal challenges. In this context, GOSKN applied to CDB for a Policy-Based Loan (PBL) in August 2006 to restructure its debt portfolio and support its fiscal strategy.

2.03 The Board of Directors (BOD) of CDB provisionally approved a PBL, valued at USD20 mn, to GOSKN on December 14, 2006, pending modifications to some elements of the conditions precedent. The revised policy conditions were approved by CDB's BOD in February 2007. The PBL Agreement was signed on May 24, 2007 and was to be completely disbursed by June 30, 2008. The PBL supported the implementation of a fiscal reform program designed to achieve fiscal and debt sustainability. The funding from PBL would also be used to replace some high-cost debt thereby reducing the average effective interest rate on Government's debt stock and further improving the debt dynamics of the reform programme. The PBL complemented a USD8.2 mn Policy-Based Guarantee (PBG) approved by CDB's BOD on October 12, 2006 in relation to an Eastern Caribbean Dollars (XCD) 150 mn bond issue by GOSKN. The level of public debt was estimated at XCD2,064 mn in 2005 or (178.3% of GDP)

2.04 GOSKN had developed a programme of reforms aimed at attaining and maintaining macroeconomic stability and promoting economic growth. The fiscal adjustment programme addressed revenue reforms, (legal and administrative); expenditure management (capacity building, multi-year budgeting and development of the public sector investment programme (PSIP), debt management (implementation of a debt strategy); and effective monitoring of Public Sector Enterprises (PSEs) to optimise their contribution to revenue and asset value maximisation.

EXPECTED OUTCOMES AND STRUCTURE

2.05 According to the Logical Framework Matrix, the goal was to improve the quality of life for the people of the Federation by promoting sustainable growth and development through the maintenance of a stable macroeconomic political environment. The expected outcomes of the PBL were:

(a) sustained reduction of the debt-to-GDP ratio;

(b) reduction in the debt burden; and

(c) timely financial reporting and improved financial performance of statutory corporations.

2.06 The PBL was structured as a two-tranche operation. Conditions precedent to disbursement of the first tranche were met in May 2008 and the first disbursement was made in July 2008. The second tranche was disbursed in September 2010 on approval by CDB's BOD on July 2010 with four conditions precedent deferred to a later date.

EVALUATION OF PERFORMANCE

2.07 The Project Completion Report (PCR) was prepared in 2013 and validated by the Office of Independent Evaluation (OIE) in 2015. The Evaluator rates the overall performance of the PBL as *Satisfactory*. This is in line with the composite score of the PCR. In respect to individual criteria, the Evaluator assigned a higher performance rating for Relevance and otherwise confirmed the PCR ratings. The Evaluator emphasises that despite the highly relevant nature of the intervention and potential sustainability of the chosen reforms, performance was undermined by inefficient implementation, observed weaknesses in effectiveness, and was constrained by inadequate monitoring and evaluation (M&E) and reporting.

BORROWER AND EXECUTING AGENCY PERFORMANCE

2.08 The Evaluator rates the Borrower/Executing Agency's (EA) Performance as *Marginally Unsatisfactory*. GOSKN appeared constrained by capacity issues to independently review and assess the feasibility of the loan conditions at the appraisal stage and effectively coordinate the implementation of the reforms across various agencies while failing to adequately communicate the issues/challenges constraining implementation.

THE CARIBBEAN DEVELOPMENT BANK'S PERFORMANCE

2.09 The Evaluator concurs with the *Satisfactory* rating of the PCR and the justification provided for the rating. CDB designed, approved and supervised a highly relevant and targeted intervention and attempted in good faith to be responsive and flexible to the changing circumstances of the country and capacity limitations of GOSKN. It facilitated the provision of technical assistance (TA) where requested to support the PBL policy actions and adjusted as necessary to facilitate disbursement. Monitoring was adequate but could have been improved with a more structured approach to data collection, analysis and reporting to ascertain and document the effects of the policy outputs and their contribution to the expected outcomes. Nevertheless, the Evaluator points out that the feedback of GOSKN suggests that CDB devotes more resources to designing, supervising and supporting the implementation, especially since at the time of approval, the PBL was a recently introduced lending instrument for CDB.

TABLE 1: SUMMARY RATINGS OF CORE EVALUATION CRITERIA AND OVERALL PERFORMANCE ASSESSMENT OF THE PROJECT

Criteria	PCR[4]	OIE Review	Justification
Relevance	Satisfactory (3)	Highly Satisfactory (4)	The PBL addressed the challenges identified in the Country Strategy Paper, supported by a fiscal adjustment programme, and leveraged support from other donors and followed on from a previous CDB Policy-Based Guarantee. The PBL was an important strategic intervention to support GOSKN's reform programme to restore fiscal and debt sustainability by strengthening macroeconomic management as well as public sector reforms and to promote good governance. The selection of a PBL, while a suitable instrument, could have benefitted from better institutional capacity analysis, risk identification and mitigation, recognition of which could possibly have flagged some of the problems that arose. It was recognised that the PBL alone would not be adequate and that additional TA commitments would be necessary, which increased the relevance of the intervention.
Effectiveness	Marginally Unsatisfactory (2)	Marginally Unsatisfactory (2)	Effectiveness was constrained by the ambitious timeframe for execution of complex policy actions. There is insufficient data/analysis to assess the extent to which the expected effects from the policy actions have impacted debt dynamics in the intermediate term. The logical framework showed weaknesses in tying all the policy actions to the expected results also hindering proper assessment of effectiveness. The subsequent debt restructuring and the effect this has had, can be partially attributed to this PBL. However the effects of capacity building of the debt unit and the Government Entities Oversight Board (GEOB)/Government Enterprises Monitoring Unit (GEMU), the rationalisation of the property tax rolls, the Public Sector Investment Programme (PSIP), sale of land in reducing the overdraft and the projected or actual impact of the corporatisation of the electricity utility were not projected or quantified.
Efficiency	Marginally Unsatisfactory (2)	Marginally Unsatisfactory (2)	The PBL was disbursed in 37 months (from date of loan effectiveness), with three conditions incomplete, compared with an estimated 14 months at appraisal contingent on satisfaction of all conditions. The protracted delays in some cases were outside of the control of CDB and the Ministry. The changed and difficult macroeconomic environment precipitated by the global economic and financial crisis resulted in deteriorating economic performance reflected in economic contraction, higher fiscal imbalances and a larger debt overhang. In this context, GOSKN had to refocus and shift priorities to address these economic imbalances. In addition, national elections in SKN delayed the implementation of sensitive policy decisions during the implementation of the PBL. The delay in establishing the single entity for land sales, which entity was ultimately made redundant by the use of the Special Purpose Vehicle under the International Monetary Fund (IMF) Stand-By Agreement, meant focusing resources on actions that in the end did not materialise as planned.

[4] PPES scores and ratings used in PCR and PSRs to be converted to PAS 2013 scores and ratings, using the equivalence matrix in the relevant PAS 2013 Manual (Public Sector Investment Lending and TA; PBL; CSP).

Criteria	PCR[4]	OIE Review	Justification
Sustainability	Satisfactory (3)	Satisfactory (3)	CDB supported a defined reform agenda, of which it was one actor. The policy actions undertaken, even though delayed, have and will be built on. The institutional capacity building activities should be sustained in the future as both the Debt Unit and GEMU will be critical agencies to manage debt; while improved property tax administration and Value-added Tax receipts will generate additional revenues. Moreover, the institutional strengthening of key departments and agencies particularly the budget office, debt management division, PSIP management and revenue agencies could enhance sustainability of the reforms undertaken under the PBL. Sustainability will also depend on the resources allocated to these agencies by the Government in the long term and the retention and continued training of staff.
Composite (Aggregate) Performance Rating	**Marginally Unsatisfactory (2.5)**	**Satisfactory** (2.75)	The PBL was highly relevant and the policy actions had strong potential for sustainability and contribution to improving debt dynamics and reducing debt once implemented. The effectiveness was compromised by non-completion of some actions and the assessment of effectiveness was challenged by limited detailed follow up analysis of the contribution of the reforms to the outcomes. The delays reduced the impact of implementing the reforms in a timely manner.
Borrower & EA Performance	Marginally Unsatisfactory (2)	Marginally Unsatisfactory (2)	GOSKN implemented some elements of the reform agenda, where resources were already committed. However, GOSKN appeared constrained by capacity issues to independently review and assess the feasibility of the loan conditions at the appraisal stage, and effectively coordinate the implementation of the reforms across various agencies while failing to adequately communicate the issues/challenges constraining implementation. At the end of 2012, 21 months after it was agreed the dated conditions should have been met, three of the four disbursement conditions were unmet.
CDB Performance	Satisfactory (3)	Satisfactory (3)	CDB's performance was satisfactory in that it designed, approved and supervised a highly relevant and targeted intervention and attempted in good faith to be responsive and flexible to the changing circumstances of the country and capacity limitations of GOSKN. It facilitated the provision of TA where requested to support the PBL policy actions and adjusted as necessary to facilitate disbursement. Monitoring was adequate but could have been improved with a more structured approach to data collection, analysis and reporting, to ascertain and document the effects of the policy outputs and their contribution to the outcome of improved debt dynamics. GOSKN suggests that CDB devotes more resources to designing, supervising and supporting the implementation, especially since at the time of approval, the PBL was a recently introduced lending instrument for CDB.
Quality of PCR		Satisfactory (3)	The PCR contained sufficient information verifiable from the available documentation to support the reporting. However, there were shortcomings in the depth of analysis, and some logical inconsistency in highlighting the negative aspects of the PBL implementation. There were some discrepancies as the PPES scores show *'Satisfactory'* ratings while the PCR Summary Ratings for specific criteria conclude *'Marginally Unsatisfactory'*. The lessons learned, Sustainability and analysis of critical factors should have been more robust to provide insights for future PBLs.

LESSONS LEARNED

2.10 The lessons learned analysis presented in the PCR was generic. The validation exercise sought to identify and analyse in greater depth how the experience of one of CDB's earlier PBLs could be applied to others under consideration:

(a) A 'home grown' reform programme, while highly desirable is not a guarantee of operational success within the fast-disbursing modality of a PBL. Care must be given to mutually establishing realistic conditions precedent during PBL negotiation and time spent up front to critically analyse the operational requirements and institutional capacities conducive to successful achievement of the individual policy reforms.

(b) It should not be assumed that a "home grown" reform programme is equivalent to a 'whole of government' approach and broad buy-in to the design of a reform programme. This has implications for efficient and effective execution when relevant agencies have not been adequately involved in the design or consulted.

(c) There should be a recognition of the difference between the extent to which a PBL 'supports a reform programme' and 'incentivises the speedy implementation of reforms'. A PBL could conceivably be supported by a differentiated structure of tranches and conditions for disbursement, depending on the overriding purpose. A fast disbursing PBL is more conducive to the former (supporting an advanced reform process), when the government is in need of liquidity support. Incentivising reforms however must include an element of rewarding actual achievement as agreed, and maintaining leverage to ensure that the reforms are completed within a reasonable agreed timeframe.

(d) While there may be no such instrument as a 'crisis proof' PBL, flexibility is required to adjust for exogenous shocks or changed conditions which can seriously delay or derail policy reforms. Policy reform conditions should not be 'set in stone' if new circumstances result in the expected result/effect of the policy action not being likely to be achieved or where the outcome of the reform is not what was originally expected. (e.g. Revenue-negative tax reform)

(e) Donor coordination can play an important role in PBL design, monitoring and sustainability. A PBL appears to work best within the context of committed multi-donor support, particularly to provide TA to undertake the reforms, and also to ensure policy coherence. In the context of this loan, CDB's TA would not have been sufficient to implement the reforms in the absence of other external resources.

RECOMMENDATIONS

2.11 Given the time lag between the completion of the PCR and the validation exercise, as well as the progress made subsequently through other donors' interventions, there are no recommendations for follow up; however, two general recommendations would be to:

(a) utilise the mechanism of the preparation of Country Assessment Reports to follow up on PBL indicators relevant to each country for at least five years (as required in the M&E conditions of the PBL) Furthermore, the format and data presented should be consistent to facilitate trend analysis.

(b) provide greater attention in the due diligence phase, particularly with respect to targeted institutional assessments and risk analysis and identification.

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MANAGEMENT RESPONSE

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MANAGEMENT RESPONSE

INTRODUCTION

1.01 The validation report is comprehensive in its coverage, clearly detailing the project description (background, rationale, expected outcomes, components – disbursement tranches and loan conditions precedent to disbursements, and implementation arrangements); a review and evaluation of the PCR [relevance, achievement of outputs and outcomes; efficiency; sustainability; performance of Borrower/Executing Agency and CDB; and monitoring and evaluation]; and conclusion (summary of performance, lessons, recommendations and project completion report quality).

FINDINGS

2.01 There were several deficiencies/shortcomings from the Report as highlighted in the document. For example:

(a) the background in project description was difficult to follow since there was no logical flow to the economic/fiscal issues under discussion. Further, the context of the problematic issues warranting the use of the PBL were not clearly defined;

(b) the rationale for PBL was not clearly presented but focused more on the Governments' reform programme;

(c) there were inaccuracies in presentation. Numerical data (which did not reflect revised and adjusted data) and explanations were at times inaccurate and confusing; and

(d) Table 2 on PBL loan conditions can be misleading. The Revision in Scope of Conditions for the second tranche disbursement made on July 22, 2010, enabled the disbursement of the second tranche with four 'dated' conditions. Appendix 3 showing matrix of outputs is incomplete and incorrect.

3.01 The Management of the Department concurs with the Evaluator's assessment of the review of PCR. The Evaluator's assessment was basically the same as the assessment from PCR. The summary assessment of outcomes (Effectiveness) of *Marginally Unsatisfactory*, was similar for both the Evaluator and PCR. Management accepts the Evaluator's rating for Relevance as *Highly Satisfactory*.

4.01 Management also agrees with the conclusions relating to the lessons in the Conclusion, particularly to specific capacities and operational steps required for the execution of the reform programme to be undertaken; the important role of donor coordination in PBL design, monitoring and sustainability; and CDB relinquishing any leverage to incentivise the pace of reforms by agreeing to 'dated' conditions beyond the terminal disbursement of the second tranche. However, the revised framework for PBL incorporates country readiness and CDB's readiness as important elements in the preparation of a PBL appraisal document to ensure country ownership for the reform programme.

5.01 Management agrees with the recommendations made in the Project Completion Validation Report (PCVR), more specifically that the Economics Department closely monitors the following set out in Table 2.

TABLE 2: RECOMMENDATIONS

NO.	PCVR RECOMMENDATIONS	RESPONSE
1.	Utilise the mechanism of the preparation of the Country Assessment Reports to follow up on PBL indicators relevant in each country for at least five years.	Agree. Particular focus should be placed on monitoring the outcomes of PBLs to ensure that PBL interventions make a tangible contribution to development effectiveness in the country. The Management for Development Framework should be utilised in this regard.
2.	Ensure balance between quick disbursement of PBL and due diligence. Greater focus should be paid in the due diligence phase with respect to understanding the operational details of the proposed reforms, targeted institutional capacity assessment and risk identification and analysis.	Agree. Greater focus is now placed on country readiness as well as CDB's readiness in the revised framework for PBL appraisals.
3.	Improved monitoring of PBL Programme.	Agree. Greater emphasis is now placed on monitoring, supervision and evaluation of the PBL.