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BUILDING FISCAL CAPACITY IN FRAGILE STATES — CASE STUDIES—PRESS RELEASE; STAFF REPORT

June 2017

IMF staff regularly produces papers covering multilateral issues and cross-country analysis. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 12, 2017 consideration of the report.
- The **Staff Report** prepared by IMF staff and completed on April 18, 2017 for the Executive Board's consideration on May 12, 2017.

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IMF Executive Board Discusses Building Fiscal Capacity in Fragile States

On May 12, the Executive Board of the International Monetary Fund (IMF) discussed the staff paper "Building Fiscal Capacity in Fragile States (FS)," which analyzes recent country experiences, describes the IMF's technical assistance (TA) approach for FS, highlights how it differs from non-FS, and derives lessons for future work.

The paper notes the importance of targeting fiscal TA to achieve stability and secure, elastic revenues. Other key lessons include prioritizing reform sequencing, promoting effective donor coordination, implementing formal Medium-Term Revenue Strategies (MTRS) and expenditure reform strategies to help countries exit fragility, as well as considering further integration of TA to FS to better complement IMF lending and surveillance operations.

The number of countries in post-conflict or fragile situations (more commonly referred to as FS) represent slightly more than twenty percent of the IMF's membership. How best to support these countries build their institutions continues to be a major concern for the IMF. In recent years, the volume of fiscal TA to FS has increased significantly, from approximately seven person years of field delivery in 2006 to nearly 30 person years of field delivery each year during the past five years (2012–2016).

The TA approach to building fiscal capacity in FS differs depending on the stage of fragility. This approach broadly takes into consideration the state of fragility: (1) midst of conflict/disaster; (2) most fragile/post conflict or disaster; and (3) fragile/stable but vulnerable. Countries often do not progress in a linear manner through these stages: they may start off in conflict/disaster, move to post-conflict/post-disaster, and then fall back into conflict or experience additional disasters. The duration of each stage varies widely across countries. The approaches described are not meant to be prescriptive or "one-size-fits-all", but to provide a sense of the principles that guide interventions in the fiscal area at various stages of fragility.

The first stage, the immediate post-conflict/post-disaster stage, includes a focus on tax revenue collection. In this stage, targeting is on easy-to-collect taxes such as customs duties at the border and selective high-yielding excise taxes, and introducing simple organizational structures and basic processes for tax and customs administration. On the expenditure side the focus is on actions that allow the authorities to gain immediate control over the budget, including preparing an annual budget, introducing basic payment systems and controls for budget execution, and consolidating cash resources for the government to meet its immediate payment obligations. Once countries become more stable (but still vulnerable), the objective of TA is to modernize fiscal institutions incrementally through medium-term revenue and expenditure strategies. Overall, reforms should be paced and sequenced to take into account country-specific circumstances and conditions, including absorptive capacity and initial conditions.

The synchronization between revenue and expenditure reforms is critical. In general, TA is provided in both areas at the same time. However, their relative magnitude varies depending on the starting conditions, the weaknesses in each area, and the country's absorptive capacity.

IMF TA responds to demands from IMF member countries, and is designed to support the IMF's surveillance and lending activities. In this regard, annual TA programs are planned in collaboration with the authorities and the IMF area department teams, and reflect evolving country priorities. IMF staff also coordinate TA advice and activities with other donors and TA providers. These coordinating efforts are easiest when they are country-led, which underscores the importance of political ownership for the long-term success of reforms.

IMF missions from headquarters (HQ) define overall reform strategies, whose implementation is supported by the ten Regional Technical Assistance Centers (RTACs), long-term advisors, and short-term advisors. All three modalities—missions from HQ, RTACs and advisors—also deliver workshops and other training activities to help develop capacity in FS. The IMF's Institute for Capacity Development (ICD) also offers training on fiscal issues to officials in FS.

Executive Board Assessment

Executive Directors welcomed the staff paper on the review of the Fund's effort to build fiscal capacity in fragile states based on recent country experiences in delivering IMF technical assistance (TA) in the fiscal area. They also welcomed the comprehensive and balanced analysis of how the TA to fragile states differs from that to non-fragile states and the lessons that can be derived for future work in this area so as to better serve this important segment of the membership.

Directors agreed that staff's strategy to building fiscal capacity in fragile states has been broadly appropriate: first, defining and implementing the needed tax and expenditure policies; second, establishing a proper legal and regulatory framework for fiscal policy; and third, establishing an effective central fiscal authority (ministry of finance) and a mechanism for coordinating donor assistance.

Directors acknowledged that the approach taken regarding TA differs between an immediate post-conflict/post-disaster stage, and a second, more stable (but still vulnerable) stage. They agreed on the staged approach, under which the focus in the first stage on the revenue side should be on securing receipts by targeting easy-to-collect taxes, with the concurrent introduction of simple organizational structures and basic processes to better manage revenue administration. On the expenditure side, they agreed that the focus of TA at this stage should be on actions that will enable the authorities to gain immediate control over the budget. Once a fragile state becomes more stable, they agreed that the second stage is to modernize fiscal institutions incrementally through medium-term revenue and expenditure strategies.

Directors stressed the need for differentiation of revenue and expenditure reforms across countries depending on the starting conditions, the weaknesses in each area, and the country’s absorptive capacity, noting that in general, it is appropriate to provide TA in both areas at both stages.

Directors welcomed the increase in IMF fiscal TA to fragile states over the past decade, which was facilitated by rising external funding. They considered the current modalities for TA delivery to be appropriate but emphasized the need for providing training to a wider range of stakeholders to ensure the effectiveness of Fund TA. Directors agreed that ensuring that the overall reform strategies are well defined by missions from headquarters is key to coherence and effectiveness in meeting the longer-term needs of fragile states. Both long-term and short-term advisors then have a framework to guide implementation of the reform strategies. Directors appreciated the supportive role played by the regional TA centers (RTACs) in the AFR, APD, MCD and WHD regions. Ensuring good coordination with other TA providers and donors, including the World Bank, is critical. Directors emphasized that TA should be demand driven and structured flexibly to support the country’s specific needs. They considered strong country ownership to be key for the long-term success of reforms. The importance of workshops and seminars, as well as other training and peer-to-peer activities, to develop capacity was also noted.

Directors recognized the considerable efforts involved in building capacity in fragile states and commended staff involved in delivering TA in often difficult and sometimes dangerous circumstances, where progress is slow. As part of future capacity development strategies, they generally agreed that increasing the intensity and duration of TA can be supported by greater use of communications technology and of short-term and long-term experts, including resident advisors, which are crucial for implementation of fiscal reforms. Directors were also of the view that increased visits by experienced staff to countries are needed to gain in-depth knowledge and provide appropriate, tailor-made support. Directors acknowledged the inherent difficulties in measuring the impact of TA on reform outcomes, both on the revenue and expenditure sides, and positively viewed staff’s efforts to gauge the possible impact of TA based on the application of standardized tools such as Public Expenditure and Financial Accountability and Tax Administration Diagnostic Assessment Tool. Directors concurred that there is further scope for integrating fiscal TA to fragile states into Fund surveillance operations. Some Directors also called for similar reviews of TA provided to fragile states by other functional departments.

INTERNATIONAL MONETARY FUND

April 18, 2017

BUILDING FISCAL CAPACITY IN FRAGILE STATES—CASE STUDIES

INTRODUCTION

This paper provides background information for the IMF Board paper on "Building Fiscal Capacity in Fragile States (FS)." It presents case studies on IMF technical assistance (TA) and capacity development in the fiscal area, provided by its Fiscal Affairs Department (FAD), in collaboration with the Legal Department, in the following countries: Afghanistan, Haiti, Kosovo, Liberia, Mali, Myanmar, South Sudan, and Timor-Leste.

These case studies provide supplemental information to the main Board Paper. They discuss experiences in building, or rebuilding fiscal policy management institutions in countries that are in various stages of fragility. Given the heterogeneity (both political and economic) of these countries, the details provided in the case studies in the various areas of fiscal policy management, shed more light on country-specific characteristics, to what extent IMF TA was successful in helping countries address them in the past, and derive some lessons that could improve TA strategies and delivery in the future. This is particularly relevant in the post-Addis context on scaling-up countries own-revenues (i.e., tax and other non-tax revenues) to achieve the sustainable development goals (SDGs).

The case studies are structured to provide detailed information on key areas of TA in fiscal policy management. First, a short background section gives the political and economic context, together with key recent events that have impacted significantly the fragile situation of the country. Second, the TA approach is described in some detail. Third, the TA provided by the IMF is outlined, both in revenues and expenditures, together with the challenges it faced and the key outcomes achieved, including their quality and sustainability, and successes and failures. Fourth, key lessons from the TA are drawn.

There is little on TA in expenditure policy in FS. This area of work generally focuses on the quality of spending, and the efficiencies that can be derived from expenditure reallocations or changes to the design of key spending items—e.g., pension and health care systems; public service wages; etc. In FS, the level of spending from own-revenue sources is generally low (as outlined in the main Board paper), both in total and in the key components of spending. Fragile countries reviewed in this paper have generally not requested TA from the IMF in this area, and relied primarily on advice from IMF surveillance and program missions. The level of spending is not, in principle, an argument against good expenditure policy practice, and the IMF has recognized this in its Capacity Development Strategy, by for example, providing workshops and training to its member countries, including FS, on how to scale back certain ill-designed subsidies—e.g., food and energy subsidies.

The lessons drawn from these case studies suggest that while some are general, others are country-specific. For example, it is clear from all case studies that commitment at the political or highest public service level is a necessary, but insufficient condition for successful reform. However, it is less clear that all FS have capacity constraints that prevent them from implementing, successfully, broad-based domestic taxes, such as the value-added tax (VAT). Kosovo and Mali have successfully implemented the VAT, but the other countries studied have not. It can be argued, and data suggest, that the Kosovo VAT performs better than Mali's (in terms of revenue), and that both perform less well than VAT in Organization for Economic Cooperation and Development (OECD) countries. But this is a debate no different from that in all countries with a VAT, including OECD countries. The point from the lessons here is that fragility calls for more attention to country-specific factors in the design and implementation of fiscal policies, particularly, the stages and types of fragility and how these may affect policy design and implementation capacities.

Another interesting result from the case studies is that it is often easier and more tractable politically to work with existing laws, even if they are weak, to rebuild basic fiscal functions of the state. The example of public financial management (PFM) TA in Afghanistan illustrates this lesson. It suggests that fundamental and big-bang style fiscal reforms should be generally doubted under certain conditions. This includes, for instance, proposing and drafting to a country complex fiscal legislation based on models in other countries. Institution building is a long-term endeavor that demands constant commitment and building on small successes.

Finally, in all cases, IMF TA suggests that basic analytical and policy design capacity are important to create and sustain good reforms in the long run. At the technical level, such capacity, which often takes the form of macro-fiscal and expenditure and tax policy units, is a key intermediary between TA providers and policymakers. Even though it has very little impact on short-term improvement in fiscal management, it has proved important for long-term institutional capacity development. The case of Haiti illustrates this well: even though very little tax policy changes were made during the TA program, the policy dialogue between donors and TA providers, and the capacity of the Ministry of Finance to own policy proposals made to the Minister of Finance improved.

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Glossary

ANDS	Afghanistan National Development Strategy
AFW	IMF Technical Assistance Center for West Africa
CBM	Central Bank of Myanmar
CFA	Central Fiscal Authority
CIT	Corporate Income Tax
CPIA	Country Policy and Institutional Assessment
CTA	Consolidated Tax Amendments
DfID	The United Kingdom’s Department for International Development
DGD	Mali’s Direction Générale des Douanes
ECF	Extended Credit Facility
ECOWAS	Economic Cooperation of West African States
EITI	Extractive Industries Transparency Initiative
FAD	Fiscal Affairs Department
FMIS	Financial Management Information System
FS	Fragile States
GDP	Gross Domestic Product
GEMAP	Governance and Economic Management Assistance Program
GoNU	Government of National Unity
HIPC	Highly Indebted and Poor Country
HQ	Headquarters
IDA	International Development Association (World Bank)
IDB	Inter-American Development Bank
IMF	International Monetary Fund
IT	Information Technology
LRA	Liberia Revenue Authority
LTO	Large Taxpayer Office
OECD	Organization of Economic Cooperation and Development
METAC	Middle-East Technical Assistance Center
MoFEP	Ministry of Finance and Economic Planning
MTFF	Medium-Term Fiscal Framework
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PIT	Personal Income Tax
PRGF	Poverty Reduction and Growth Facility
RM-TF	Revenue Mobilization Trust Fund
SDG	Sustainable Development Goals
SDP	Strategic Development Plan
SSTF	South Sudan Trust Fund
TA	Technical Assistance
TSA	Treasury Single Account

UN	United Nations
UNMIK	United Nations Mission in Kosovo
USAID	United States Agency for International Development
VAT	Value Added Tax
WAEMU	West African Economic and Monetary Union
WB	World Bank
WTO	World Trade Organization

AFGHANISTAN[1]

A. Background

1. Afghanistan has been experiencing external and internal conflict since April 1978 when the communist party of Afghanistan seized power and the opposition launched an uprising that turned into a civil war, and resulted in intervention of the Soviet Union. Following the break-up of the Soviet Union, the Islamic State of Afghanistan was created in April 1992, but quickly broke into war, and was taken over by the Taliban, which caused much destruction and human loss.

2. The Taliban rule ended in December 2001. A new government was formed, and the country received support from the International Security Assistance Force, an interim international force established by the United Nations Security Council to assist the Afghan government in maintaining security in its territory. Reconstruction of the country started soon after, with the help of several international organizations and non-governmental organizations (NGOs). The Fund started TA in 2002. This has proved challenging, however, because of the continued existence of armed insurgent groups.

3. Despite significant efforts to build democratic institutions and improve the country's economy and public services, Afghanistan remains one of the poorest countries in the world. Country Policy and Institutional Assessment (CPIA) scores are very low, and have even deteriorated between 2005 and 2013, especially in fiscal policy, financial management, rule-based governance, quality of public administration, transparency, accountability and corruption in the public sector.

4. Afghanistan continues to have one of the lowest rates of tax collection among IMF member countries (about 10 percent of gross domestic product (GDP), although revenue growth has picked up markedly in recent years. The low capacity of the revenue administration and public financial management compounded with the poor security situation in the country has made it difficult to implement sustainable revenue mobilization and expenditure management reforms. Due to very limited tax administration capacity, the introduction of a VAT had to be postponed until at least 2020 after legislation was submitted to Parliament in 2014/15. On the expenditure side, the country has been highly dependent on donor support.

B. Technical Assistance Approach

Revenues

5. In tax policy, TA to mobilize revenue has focused on indirect taxation and extractive industries (EI). The advice included: (1) consolidating and modernizing indirect taxes, which remain the main source of revenue (an ambitious objective was to replace the business turnover tax with a

[1] Prepared by Racheeda Boukezia, Diego Mesa-Puyo, and Vincent de Paul Kocou Koukpaizan.

VAT for the large taxpayers, to boost revenue by around 3 percent of GDP); (2) improving the quality of direct taxes, in particular to foster foreign investment; and (3) reforming the taxation of EI to increase the government's share of the resource rent, in collaboration with United States Agency for International Development (USAID) and the United Kingdom (UK)'s Department for International Development (DFiD), which provided TA on EI. TA missions have taken place outside Afghanistan for security reasons.

6. In tax administration, a 2010 mission recommended concentrating reform efforts on high yield taxpayers. This included ensuring all large taxpayers are administered by the large taxpayer office (LTO), expanding the LTO control over the taxpayers that contribute to at least 70 percent of total collections, introducing risk based processes at customs and abandoning 100 percent verification, and strengthening post-clearance audit capabilities. In recent years, and due to the security situation, delivery of in-country TA in revenue administration has been impossible, and the IMF involvement in this area has been rather limited.

Expenditures

7. The initial engagement in PFM started with a fiscal assessment mission in February 2002. It found that a PFM system consistent with some good practices, including laws and procedures,[2] existed on paper but had broken down during the war. The approach adopted was to build on these structures and initially focus on core PFM reforms including computerization of payment procedures and fiscal reporting, as well as consolidation of bank accounts. A resident technical assistance advisor was assigned to the treasury in Kabul from 2004 to 2006 to help implement a new Financial Management Information System (FMIS). From 2006 onward TA covered the organization of the Ministry of Finance, budget formulation, cash management, and fiscal reporting. This was done through a combination of headquarters missions and short term expert visits from the IMF's Middle-East Technical Assistance Center (METAC). TA was complemented by other donors.[3]

C. Key Issues and Outcomes

Revenues

8. Progress in tax policy has been slow compared to PFM reforms, due to capacity issues and lack of coherent political commitment among the various parties. Although some relative success has been achieved on excises, these do not account for much revenue. A reform to the income tax is also in the making, but it is not expected to bring many additional resources either. An

[2] These included a PFM Law; a simple chart of accounts, which was largely based on the fiscal reporting used by the IMF in the seventies; a budget law; and an expenditure management manual dating back before the Russian occupation (source: *Discussion Paper: Donor funding and PFM reforms in post-conflict countries: recommendations derived from personal observations*, Steve Symansky, November 2010).

[3] The Asian Development Bank (ADB), European Union (EU), DFiD, United Nations Development Program (UNDP), USAID, and the World Bank (WB) have been particularly active in the country.

FAD tax policy mission in February 2017 proposed four measures to increase revenues: (i) increase non-tax revenue (as already envisaged by authorities); (ii) prepare the introduction of 4G cell phone licenses to maximize their price; (iii) introduce a minimum corporate income tax (percentage of turnovers), and; (iv) increase the corporate income tax (CIT) withholding at customs. The VAT initiative has faced a severe setback and is not expected to be adopted before 2020, and may take the form of a marginal improvement to the design of the existing sales tax (which has a limited crediting mechanism for input taxes). Capacity issues, coupled with the need for a higher VAT rate have proven to be significant obstacles.

9. The IMF also helped in the design of the tax regime for EI. Two TA missions took place since 2013. These missions built capacity in understanding the analytical work underlying the evaluation of taxation regime options, helped the authorities in evaluating their own options for reform, and made several recommendations to modernize the corporate income tax (CIT), including elements of international taxation. One key institutional recommendation was to establish a formal EI tax unit within the LTO of the Afghanistan Revenue Service Department, to undertake monitoring and other analyses regarding the sector.

10. One key outcome of this TA was the development, by the Ministry of Mines and Petroleum, of a policy paper entitled *Fiscal Policy Options for the Mining Sector in Afghanistan.* The paper contained many IMF recommendations, and signaled government ownership of the reform. But the authorities were not able to advance the reform agenda, in large part due to personnel turnover and lack of political commitment. The mining and petroleum sectors continue to develop slowly, but are expected to be significant contributors to economic growth in the future. There is a risk that, without an adequate tax system in place, the country will not be able to reap its fair share from the mining rent.

Expenditures

11. When the Interim Administration took office in January 2002, the fiscal and financial functions of the Ministry of Finance were not operational. Significant efforts were needed to restore fiscal control, rebuild a functioning Ministry of Finance, and gradually improve PFM. At the recommendation of the IMF, priority was given to strengthening expenditure controls, fiscal reporting, and accountability through the computerization of PFM systems as well as consolidation of the government's bank accounts to move to a Treasury Single Account (TSA).

12. Progress in implementing FMIS, which was acquired as an off-the-shelf system, was remarkable despite some resistance at the early stage of the process. A key factor in the success was the acceptance by the authorities to implement the system without too much customization. Upgrades to the system were gradual and coincided with improvements/revisions to the existing procedures after comprehensive analysis performed by the treasury and budget departments. Progress toward a sounder cash management system was timid with several issues, notably a lack of adequate coordination between the budget department's in-year allotment management and the treasury department's cash forecasting and management functions. Unpredictability of cash flows from donor disbursements was another challenge.

13. **Quickly after these first PFM improvements, organizational reforms were undertaken to streamline the Ministry of Finance's structure and consolidate its core functions.** The Ministry of Finance prepared a five-year strategic plan in 2005 and progressively developed a more efficient organization. In parallel, more sophisticated PFM reforms were undertaken, including introduction of new PFM laws and financial regulations, gradual implementation of program budgeting,[4] and multi-year budget preparation, mostly at the level of the medium-term fiscal framework. The Afghanistan National Development Strategy (ANDS) was developed to set national priorities to facilitate a more coordinated approach to integration of donors' budgets. These reforms were all supported by the donor community and led to increased confidence in the government's financial management capacity.

14. **Despite the improvements, the capacity of the Ministry of Finance remains fragile, especially within the Budget department.[5]** A key issue is the lack of skilled local staff as well as a significant gap in the levels of remuneration offered by the administration in comparison with those offered by the donors or contracting organizations. This led to a heavy reliance on international experts and contracted TA. Consequently, the IMF designed a TA strategy with more emphasis on capacity building and targeted advisory assistance, with a training component to be provided by METAC. Weaknesses also remain in budget preparation as the budget, particularly as regards the capital budget, is unrealistic and not consistent with the priorities defined by the government in the ANDS.

15. **The 2010 PFM roadmap aimed at increasing the transparency and effectiveness of public spending and enhancing fiduciary controls.** A primary objective was to ensure that, ultimately, development aid be channeled through the budget. The strategy was aimed, *inter alia*, at (i) strengthening the budget by implementing a simplified version of program budgeting; and (ii) improving the medium-term expenditure framework by incorporating recurrent costs of development spending, security spending, and other fiscal pressures. Some achievements were noted between 2010 and 2013, including the implementation of a basic approach of program budgeting in line ministries, but the Medium-Term Fiscal Framework (MTFF) remained inadequate as fiscal sustainability analysis was absent.[6] During this period, the IMF continued to support the Afghan authorities in developing a strengthened and more sophisticated MTFF.

16. **The IMF stopped its in-country TA from 2014 to 2016 due to the security situation**. However, it started out-of-country assistance in 2016, following a request from the authorities for an

[4] This reform was driven mainly by other donors. The IMF recommended a simple programmatic approach to align the authorities' and donors' policy priorities and to phase in changes, subject to certain prerequisites being met at each phase.

[5] The Budget and Treasury Departments pursued different strategies. The Treasury could gradually build internal capacity and make major advances towards reducing its high reliance on donor-funded Afghan positions. Only a small number of key positions at the Treasury were funded by donors.

[6] This was critical in the Afghan context due to the increase in security spending after 2014, when security responsibilities were gradually being transferred from the international community to the government, and the potential budgetary impact of operational costs of the large inventory of donor-created physical assets, of which the government had no information, being transferred on-budget.

Extended Credit Facility (ECF) program. An assessment mission found that recent progress has been very slow and identified, with the authorities, some immediate priorities to strengthen the PFM system. Among these were reforms that had been initiated in 2010 but not fully implemented.

D. Lessons Learned

- Capacity to manage the implementation reforms is crucial. Large and ambitious reforms are difficult to be implemented in a sustainable way, and should be avoided. It is better to have a more gradual and realistic approach.

- Lack of coordination across relevant ministries hampers reforms. This was most evident in the attempted reforms for the taxation of EI. The lack of political commitment worsens coordination across ministries. Despite this, some progress is possible, as was evident from the establishment of risk analysis committees to guide the selection of tax audit cases.[7]

- Building on past legal structures after a major conflict can facilitate political buy-in and encourage a stronger involvement from the authorities. This enables the authorities to work with legislation that they are familiar with, promote a greater focus on immediate priorities, and avoid wasting time on drafting and implementing new legislation in an environment of weak legal and parliamentary institutions.

- Reinforcing core fiscal functions, such as budget execution, is critical. This is even more important when the country depends on external financing from the international community. Diverting focus from the basics of PFM to more complex reforms should be avoided, as unrealistic and unsuitable reforms often lead to frustration and reduced political support. Building greater domestic PFM capacity at the very early stage should also be a priority, especially in post-conflict countries where there is a limited pool of local skilled people and where remuneration in the public service is lower than needed to attract and retained skilled personnel.

HAITI[8]

A. Background

17. Haiti has been a FS for a long time, but the January 2010 earthquake that devastated the country aggravated its fragility. Haiti is also exposed to other frequent natural disasters, the latest of which was the Category 4-Hurricane Matthews in 2016 with damage equivalent to

[7] The output of the Risk Analysis Committees has been used to select audit cases and allocate resources, and audit performance show an appreciable improvement in 2015 compared to 2014; actual collections from audit assessment increased from 14.8 percent to 44.5 percent; LTO audit collections have risen from 15 to 21 percent as a proportion of total LTO collections; net operating losses disallowed have risen from Afghani (AFS) 4 billion to AFS 14.4 billion.

[8] Prepared by Lewis Murara, Patrick Petit, and Yves De Santis.

23 percent of GDP. Fiscal institutions are for the most part at their infancy. The budget is rarely passed by parliament and, when it is, it either comes too late in the fiscal year or it is incomplete.[9] The planning and budgeting functions are not integrated. Budget execution was cumbersome due to a dispersion of fiscal powers across line ministries, with very limited fiscal oversight by the Ministry of Finance (fiscal reporting was almost nonexistent, and until 2014, fiscal accounts did not include any data on capital spending). Cash rationing was prevalent, and central bank advances to the treasury helped keep the government operating. Trust in government by suppliers has been so eroded that payments are required before goods and services are delivered.[10]

18. The earthquake had dramatic consequences for the Treasury and the tax administration as their buildings collapsed, killing many of their staff. This catastrophe occurred at a time when the need for revenue to rebuild was most felt, and the capacity of the State and its tax administration were drastically affected.

B. Technical Assistance Approach

Revenues

19. The IMF set up a multi-year TA program in tax policy and administration in 2012. Its main goal was to modernize and simplify Haiti's tax system to ease enforcement and compliance burdens, and facilitate the introduction of new measures to broaden the tax base, particularly from personal income tax (PIT) and CIT.

20. The revenue administration became totally disorganized because of the 2010 earthquake.[11] Therefore, TA in tax policy and administration had to focus on simplification of the policy framework, and ensuring basic operations of the tax administration.

21. In tax policy, initial support focused on guiding the authorities in setting up a tax policy unit (TPU) to serve as the pillar for conducting policy analysis and developing policy options. A series of TA short-term expert visits from mid-2012 to early-2013 were deployed to gradually strengthen the TPU's capacity, including through the assignment of increasingly complex tasks. This was complemented by videoconferences, and other forms of support from IMF headquarters. Support was also provided to initiate the consolidation of various tax laws into a single tax code, which reflected some of the recommendations from the TPU's studies.

22. One example of the specificity of the advice was the recommendation to apply the VAT (when introduced) solely to large taxpayers with turnover of US$ 800,000 and higher. An

[9] For example, the 2015/2016 budget was issued by decree and did not include capital spending.

[10] Despite the existence of an external audit office, the accounts of government have not been audited since 2009. An internal audit unit exists within the Ministry of Finance, but its scope is mostly limited to ad hoc reviews and investigations.

[11] For example, only 30 percent of the tax and customs revenues forecasted were collected in January 2010.

unusually long transition period was also favored considering the country's weak capacity and the importance and concentration of indirect taxes in Haiti.[12] The IMF also offered advice in other areas, including assisting in the draft of a Mining Code in 2013, introducing final withholding at source, eliminating certain deductions from personal income tax (PIT) and CIT, streamlining tax exemptions, and eliminating discretion in their attribution.

23. In the tax administration area, the IMF provided advice on the reorganization of the tax department. Its recommendations included the clear delineation between headquarter and operational functions, strengthened and function-based headquarter units,[13] and the organization of operational offices based on taxpayer segmentation, primarily by size of turnover.

Expenditures

24. Until 2014, Haiti did not have a PFM reform strategy. Reform initiatives were ad hoc, based on the most pressing needs, such as treasury management which was the initial focus of IMF support. The PFM reform strategy was mostly donor-led, and placed undue emphasis on advanced reforms such as program-based budgeting and medium-term budget frameworks.

25. Given the multitude of donors intervening in the PFM area after 2010, the IMF focused on three critical areas. First, building a macro-fiscal unit to help prepare a credible budget; second, establishing a TSA to allow the government to channel available funds more efficiently per the priorities set in the budget for a greater development impact; and third putting in place a fiscal reporting system to account for the use of resources. In each of these areas, the IMF coordinated with other donors, including the World Bank (WB), European Union (EU), United States Treasury, Canada, and the Inter-American Development Bank (IDB). For example, to implement some of the IMF recommendations regarding strengthening fiscal reporting, the existing information technology (IT) systems were inadequate for proper data recording and reporting; the IMF coordinated with the WB, which quickly provided through one of its ongoing projects in Haiti the financing to upgrade the IT system.

26. To overcome various challenges, a combination of TA delivery modalities was used. The IMF placed a resident advisor, initially within the Treasury Directorate, and later directly under the Minister of Finance. A series of short-term expert visits also provided detailed guidance on specific topics. Missions visited the country on a regular basis to provide additional guidance. Desk reviews were done on topics that did not require travel, such as drafting or reviewing legislation. Finally, the IMF encouraged the Ministry of Finance to partner with Haiti's School of Administration to mainstream PFM training into their curriculum and facilitate some of the ad hoc workshops and

[12] The turnover tax that the VAT was meant to replace accounted for roughly 40 percent of total revenue, two- third of which was collected at customs. While the revenue risk from a new policy was high, this concentration also provided a good collection handle.

[13] A function-based organization consists of designing and applying the key functions of revenue collection to all taxes; these typically include registration, filing, assessment, audit, dispute resolution, etc. This modern type of organizing tax administration is in contrast, and more efficient, to an organization by type of tax, or some other dimensions.

seminars delivered by the IMF to advance capacity development. Furthermore, successive IMF programs included PFM conditionality, which helped TA delivery and implementation. The establishment of a TSA which is operational since late 2015, as well as the creation of accounting functions to support fiscal reporting (implemented in 2014) were among the key program measures.

C. Key Issues and Outcomes

Revenues

27. While undoubtedly exacerbated by the earthquake, the historically poor revenue performance in Haiti has also been symptomatic of fundamental issues underlying the country's taxation policies and revenue administration. The complexity of the local political and institutional situation made external TA for reforms very difficult. For most of the 1990s and 2000s, Haiti's tax-to-GDP ratio was below 10 percent. The 13.3 percent realized in 2015 is a commendable improvement, but it is unlikely to be sustainable given that it is primarily driven by the indirect impact of reconstruction efforts, which will decline over time.

28. At the launch of the multiyear TA program in revenue policy and administration in 2012, a key issue was the lack of an institutional anchor. In addition to the IMF, several bilateral agencies had sizable TA programs;[14] this included the Canadian International Development Agency, the US Treasury, and the IDB. Despite this intense support, the weak capacity of the Ministry of Finance in coordinating TA, was a determinant factor in holding back reforms in tax policy and administration.

29. Throughout the project, the authorities were slow in making the required organizational changes. Even if during 2014 reform had gained traction, the inadequate strategic management and political uncertainty and interferences in operations of tax administration (e.g., three general directors were appointed in one year) were serious impediments to reform. At the end of the TA program, the main milestones were only partially achieved.[15]

Expenditures

30. Reforms were hindered by institutional instability, including very high turnover at high and middle levels (for the last five years, the Minister of Finance changed five times). This was, for example, the case of treasury reforms, which was compounded by the lack of interest from the central bank. There was also a great deal of resistance from line ministries which perceived the reform as taking away their powers over their respective sectoral spending. Nevertheless, with

[14] IMF TA was small relative to the total provided by the other bilateral agencies.

[15] A function-based organizational structure for the Tax Department headquarters has not been implemented. Taxpayer segmentation was in place, but not all taxpayers have been transferred to the respective large or medium taxpayer office.

persistent IMF TA, a macro-fiscal unit was established in 2013, accounting functions were created in 2014, and Haiti now has an operational TSA covering budgetary central government since 2015.

D. Lessons Learned

- It is important for the authorities to be committed to reforms, and to invest in necessary human resource structures and leadership.
- Setting up macro-fiscal and tax policy units created an enabling environment for TA, and proved to be a success. This was irrespective of the size and quality of reforms undertaken. However, it became clear by mid-2013 that many challenges, including institutional instability, prevented TA from having a sizable and lasting impact on the employees of the Ministry of Finance.
- In revenue administration, a large amount of uncoordinated TA by various organizations raised significant challenges and proved counterproductive.
- Some success in PFM reforms could have been larger and achieved faster if there were better functioning state institutions.
- The presence of a long-term resident advisor was essential to maintain the support during the implementation of the TSA. It is likely that this reform would not been possible or at least delayed significantly without this permanent local support.

KOSOVO[16]

A. Background

31. Kosovo's post-conflict state-building faced several challenges. These included parallel authorities competing for legitimacy, powerful regional clans, a criminal-political nexus, ethnic polarization, weak jurisdictional control in areas rich in mineral resources, ineffective governance, and corruptive practices.[17] While Kosovo's CPIA score averaged 3.5 percent in 2009 through 2015, higher than the threshold for classifying a country as fragile, the continued presence of United Nations (UN) peace-keeping operations exposes the country's fragile context.[18]

32. State-building in Kosovo since 1999 has developed in the context of contested recognition of its right to be independent.[19] Following the dissolution of Yugoslavia, the UN was entrusted with governing Kosovo through its interim administration mission, the United Nations

[16] Prepared by Enriko Aav, Martin Grote, Johann Seiwald, and Irena Jankulov Suljagic.

[17] Montanaro, Lucia. *Kosovo state-building conundrum: Addressing fragility in a contested state*. FRIDE, 2009.

[18] Per the IMF classification, "FSs" either have a harmonized average CPIA rating of 3.2 or less, or have had the presence of peace-keeping or peace-building missions during the past three years.

[19] Tavakoli and Saneja. *Public financial management in fragile states: the case of Kosovo.* Overseas Development Institute (ODI), 2012.

Mission in Kosovo (UNMIK), under UN resolution 1244 of 1999. In 2002, the Provisional Institutions of Self-Government were established, and in 2008 the Kosovo unilaterally declared independence. It has still not been recognized by two of the five permanent members of the UN Security Council; five out of twenty-eight EU members; and Serbia.

33. As a lower middle-income country, Kosovo's bewildering political relationships weigh on its economic development. The country joined the IMF and the World Bank Group in 2009 and signed the Stabilization and Association Agreement with the EU in 2015 as an important step in the accession process. About 30 percent of the population is considered poor. The economy is supported by a large diaspora providing remittances in the range of 18-29 percent of GDP. The WB's 2015 CPIA found persistent problems with misuse of public resources, lack of quality in public administration, corruption, lack of transparency, and rules-based governance.

B. Technical Assistance Approach

Revenues

34. Kosovo is an outlier relative to other FS, in that its revenue-to-GDP ratio averaged 25.0 percent over the period 2013-16 percent, while the FS' average is less than 14 percent. Due to this characteristic, which places Kosovo in a situation like a lower-middle-income country, IMF TA focused on efficiency and equity-enhancing tax reforms. Modern recurrent property tax could only be introduced after a cadaster had been established and refined aerial photography in map format of the built-up area was provided to local governments.

Expenditures

35. In the PFM area, TA included the establishment of the Central Fiscal Authority (CFA), and the development of the decentralization strategy. This took place in close coordination with other key donors and TA providers.

C. Key Issues and Outcomes

Revenues

36. In revenue policy and administration, Kosovo's economy and institutional set-up revealed the potential of raising additional domestic revenues. Commonly, some FS struggle to raise own-revenues due to several factors such as over-reliance on taxing EI, low tax morale of its citizens, weak tax administration, and narrow tax bases because of a proliferation of tax incentives.[20] To overcome these hurdles, the IMF provided TA in tax policy to Kosovo for the non-natural resource sectors (2008; 2011), tax administration (2010-16), and taxation of EI (2012).

[20] OECD, 2014, Fragile States 2014—Domestic Resource Mobilization in Fragile States, Paris.

37. As a priority, IMF tax policy advice sought to increase revenues by increasing the share of direct taxes, which accounted for about 18 percent of the total. It focused its TA on the following key areas: (1) broadening the PIT and CIT bases by rationalizing tax expenditures; (2) improving recurrent property taxation; (3) limiting tax base erosion through excessive interest deductions; and (4) broadening the use of excises (traditional excises and environmental charges). It was encouraging that the authorities were willing to extend the use of environmental taxes over and above fuel taxation—e.g., packaging waste charges—something that would not be standard tax policy in the case of fragile countries.

38. IMF advice on the taxation of EI sought to increase the responsiveness to profitability by proposing an increase in the CIT rate, and reinforce rules that protect the tax base. This included limiting company gearing by capping interest deductions, maintaining internationally competitive *ad valorem* royalty rates for metallic minerals (specific royalties for lignite), imposing a 5 percent withholding tax on non-residents' technical service delivery, introducing a capital gains tax on the transfer of mining interests, including gains from the sales of shares attributable to immovable assets, and adding a 10 percent cash flow tax surcharge. The minerals sectors' contribution to total revenues increased from 0.7 to 2.1 percent of GDP for 2012-2015.

39. Technical support on tax administration focused on the modernization of the Kosovo Tax and Customs Administrations. This included core tax administration processes (debt collection, audit), managing large taxpayers, and tailoring administrative activities to specific tax risks. In addition, building trust and cooperation with taxpayers became a priority. These reforms helped to improve revenue collection and achieve cost-effective use of administrative resources. Indeed, tax compliance management by the Kosovo Tax Administration is considered as regional best practice.

40. Kosovo's authorities also decided to pursue several challenging reforms to raise more revenues and fight corruption. The most prominent reforms included a merger of the customs and tax administrations. The IMF provided extensive TA to manage the organizational risks associated with such a reform, which is challenging for any country.

41. These revenue policy and administration initiatives helped Kosovo increase tax revenues from about 20 percent of GDP, to 23 percent in 2009-2015. Considering the large presence of the international donor community in the country, IMF TA was coordinated with other institutions, most notably Swiss State Secretariat for Economic Affairs (SECO), USAID, EU and the UNMIK, to ensure consistency in the policy dialogue with the authorities. But political economy factors still led to a deterioration of the VAT; instead of moving toward a single rate, the standard rate was increased, and some consumption items were either exempted or zero-rated.

Expenditures

42. In PFM institutions had to be developed following the war in 1999. This was a result partly of the nature of the peace resolution, and partly from the highly-centralized PFM structure in existence before the conflict, whereby most functions were performed in Belgrade. This situation called for a different TA strategy than that adopted for revenue policy and administration issues, which was more typical of a FS. Thus, in the immediate aftermath of the conflict, operating systems were nonexistent; the number of qualified Kosovars with experience in public administration was limited; and constitutional, legal, and institutional structures had to be established. Considering the politically sensitive situation in Kosovo, and the need to establish new institutions under the UNMIK administration, experiences from Western countries were used instead of the ex-Yugoslav legacy. The new PFM system was based mainly on an Anglo-Saxon model of PFM.

43. A key priority was the establishment of basic PFM institutions. As a first step, UNMIK established the Central Fiscal Authority in 1999 to be responsible for the overall financial management of the Kosovo budget. Its tasks included budget preparation, budget execution, treasury functions, public procurement, tax collection, and customs administration. Basic instruments and procedures were built up, focusing on controlling inputs and accounting for cash, together with strengthening budget planning.

44. In this early stage of PFM reforms, the IMF provided timely strategic advice. A TA mission in 1999 provided a detailed blueprint for the establishment of the Authority and the set-up of budgetary institutions, and follow-up assistance to help implement the recommendations. The core thrust of the advice focused on developing a reliable budget execution system, including ensuring transactions were properly recorded, before embarking on more sophisticated reforms. In cooperation with EU and the WB, projections for revenues and recurrent expenditures were also provided to form the basis of an initial request to donors for budget support. A comprehensive reform plan was not developed by the donors.

45. Following this initial advice, IMF TA slowed down.[21] In 2001, the Ministry of Economy and Finance, managed by the Provisional Institutions of Self-Government, was created, and PFM responsibilities were gradually transferred from the Central Fiscal Authority.[22] At the same time, a constitutional framework and the Law on PFM Accountability were drafted and implemented, mainly supported by USAID and the WB. To address more short-term concerns, the IMF provided complementary TA on budget classification and chart of accounts, which enabled Kosovo to produce and publish comprehensive and timely fiscal data for budget out-turns. This, in turn, helped reduce the opportunities for corruption,[23] and improve the Public Expenditure and Accountability Framework (PEFA) score—from "D" to "A."

46. In the run-up to independence in 2008, the IMF provided further support to develop a strategy for fiscal decentralization. In the context of the Ahtisaari Comprehensive Proposal for Kosovo Status Resolution, a TA mission in October 2007 proposed a general framework for the decentralization initiatives under way; advised on some design features, such as municipal financing;

[21] Because Kosovo was not a member of the IMF until 2008, the IMF was restricted in providing technical assistance.

[22] UNMIK's role remained strong, however, with the mandate to review the budget before submitted for approval and to receive fiscal reports.

[23] Symansky, Steve, November 2010. Discussion Paper: Donor funding and Public Finance Management (PFM) reform in post-conflict countries: Recommendations derived from personal observations.

recommended a phased implementation approach for the proposed reforms to allow institutional capacity to keep pace with policy changes and to ensure stakeholder buy in; and defined next steps to address the fiscal challenges related to municipalities. A new law on local governments led to a significant increase in grant financing and preceded a clear and comprehensive assignment of municipal competencies, but weakened municipalities' incentives to raise their own-source revenue. Thus, a follow-up mission in 2010 recommended strengthening incentives for collecting own-source revenues by granting more autonomy in their use. Thus, the share of municipal revenues that local governments can spend freely in accordance with applicable national laws increased from 40 percent in 2007 to 47 percent in 2012.[24]

47. Following the declaration of independence in 2008, the authorities took ownership of the PFM reform agenda. Before independence, there was no government-owned PFM reform plan, and the reforms were mainly driven by different donors. In 2009, the first government-produced comprehensive and integrated reform plan for PFM, with assistance from the donors. This reform focused on debt and cash management.

48. After this strategic intervention, the IMF provided ad hoc support on other PFM issues. From 2009 to 2015, several missions provided TA in a diverse range of areas, such as cash management, expenditure arrears management, and fiscal rules. A Public Investment Management Assessment (PIMA) was conducted in 2015, followed by support to implement recommendations on improving project appraisal and selection. The assessment revealed that most of Kosovo's public investment institutions, which were developed with considerable support of donors, were of medium or good strength on paper, but much weaker in their practical implementation (e.g., the public investment program is a well-established database with comprehensive guiding notes, but data quality is poor due to a lack of a quality assurance process).

49. Despite the challenging environment, PFM institutions in Kosovo have improved significantly over time. The 2006 Public Expenditure and Financial Accountability (PEFA) assessment showed some progress with the transfer of competences to the Ministry of Economy and Finance, but also weaknesses related especially to the budget classification and medium-term budgeting. From 2006 to 2009, the PEFA scores improved in one-third of the indicators, and a similar development took place from 2009 to 2013. Kosovo now has a sound legal PFM system, a very good and operational treasury system with a treasury single account, an integrated IT system, a well-established Macro-Economic and Fiscal Policy Unit, and has improved its external audit function.

D. Lessons Learned

- Political economy factors can temper with the authorities' appetite for adopting reforms. Kosovo's revenue effort of 20 percent of GDP was solid to begin with. Advice for rationalizing tax

[24] Committee of Regions, November 2014. Division of powers between the European Union, member states, candidate and some potential candidate countries, and local and regional authorities: Fiscal decentralization or federalism.

expenditures, making greater use of environmental charging, reducing inefficiencies and overly burdensome compliance, and improving EI taxation were acknowledged as being sensible, yet political economy factors tempered the authorities' appetite for adopting reforms.

- The need for addressing some skills deficits in core technical staff is a key determinant of the pace of tax policy and administration, and PFM reforms.
- The authorities' wish to proceed briskly with an integrated tax and customs administration needed tempering to ensure a proper foundation, and appropriate sequencing that would not disrupt business continuity.
- The scope of reform underline the importance of maintaining a longer TA association with a country, with the view to influencing positively contemplated changes and initiatives against a relatively unstable political environment.
- A comprehensive and integrated reform plan helps a more efficient use of donor resources. The absence of a comprehensive PFM reform plan until 2009 created inefficiencies in using donor resources and duplication. This led in some cases to duplication of reform efforts and the weak integration of reform outputs.
- The largely donor-driven PFM reform agenda had its limits in motivating ownership of reforms. The absence of a government-owned PFM reform plan until 2009 contributed to limited capacity and appetite to plan, coordinate, and drive the PFM reform process.

LIBERIA[25]

A. Background

50. Liberia emerged from civil war in 2003, facing an infrastructure in complete disrepair, little economic activity, and a cash-strapped government saddled with a high debt burden. The country's socioeconomic structure was characterized by inequality of income, lack of education and opportunity, and social tensions. It took a few years after the end of the war for the economy to gather momentum, and for government to embrace economic reforms. Foreign assistance flooded the country to assist with the reconstruction efforts, especially after the presidential elections and the signing of an IMF-supported Staff Monitored Program in 2006.

51. The Governance and Economic Management Assistance Program (GEMAP) was established for 2005-2010 to facilitate donor coordination. Under this program, responsibilities for TA in fiscal policy was allocated principally to the IMF and the WB. In 2010, Liberia's payment arrears to the IMF were cleared under the Heavily Indebted Poor Countries (HIPC) initiative, and the country could access IMF resources under the Poverty Reduction and Growth Facility (PRGF).

[25] Prepared by Lesley Fisher, Alpa Shah, and Rebecca Sparkman.

52. After a decade of strong performance (2003 to 2013), growth abruptly stalled in 2014 due to the Ebola outbreak and the decline in international commodity prices. Real GDP growth dropped from 8.7 percent in 2013 to 0.7 percent in 2014, and 2015 saw no growth. Output and revenue from mining concessions fell, adding extra pressure on the budget, particularly health spending to fight the Ebola crisis. By June 2016, Liberia was declared Ebola free, and medium term forecast growth now is estimated to stabilize at 6 percent over the next five years.[26]

B. Technical Assistance Approach

Revenues

53. The IMF undertook a needs assessment shortly after the signing of the Accra Peace Agreement in 2003, which marked the end of the Second Liberian Civil War. In revenue policy and administration, the TA approach began with a basic short- and medium-term actions list to increase government revenue. After the January 2006, presidential election, Liberia's reform program proceeded rapidly. To support the program, the IMF coordinated with other donors and took a multi-faceted approach to the delivery of TA in tax policy and administration. TA was delivered in phases on a range of topics, to help create a tax system based on sound economic principles, broad tax bases, and limited discretionary tax policy. In 2011, the IMF launched a multi-year TA program financed by the Tax Policy and Administration Topical Trust Fund (TPA-TTF). It focused on strengthening the revenue administration organization, defining the organizational structure, administrative and operational frameworks, building a comprehensive risk strategy for large taxpayers, and building the capacity of the Liberia Revenue Authority (LRA) to service taxpayers.

54. From 2015, several TA activities started to deal with the particularities of customs administration. Having noted the first positive steps taken by LRA and demonstrated commitment of LRA to move forward with customs administration modernization, the approach adopted for TA was to promote progress of core functions toward international standards. This included the preparation for implementing the World Trade Organization (WTO) rules on import valuation given that WTO accession was underway, and capacity building in modern customs techniques such as risk management and post-clearance tax audit. In addition, since the Freeport of Monrovia has the potential to become a regional transit port in the future, Liberia Customs has been included in a TA project benefiting West African coastal countries and aimed at a coordinated modernization of the customs procedures in use in their seaports.

Expenditures

55. In PFM, the IMF provided substantial support through a long-term resident expert and advisory missions from headquarters to develop the Public Finance Management Act and regulations, and to craft a PFM reform strategy and action plan. Due to slow progress, the IMF intensified its TA after 2012, by complementing its long-term experts with in-country training on

[26] IMF Staff Report for the Fifth and Sixth Review under the Extended Credit Facility Arrangement, December 2016.

budget formulation and public investment management, exposure of government officials to concepts and principles in PFM through study tours at international institutions and neighboring countries, and short-term expert visits and training from officials in neighboring countries.

56. TA provided in-country came to a halt with the outbreak of the Ebola epidemic. However, the IMF continued its support through remote interactions with government officials, including conference calls, Skype sessions, and ongoing email exchanges. In-country TA resumed when travel restrictions were lifted, and included posting long-term experts in revenue administration. The IMF also organized a workshop for a broad range of senior government officials to define post-Ebola strategic plans in revenue policy and administration, and PFM, and to address human resource capacity issues related to the intensity of TA.

C. Key Issues and Outcomes

Revenues

57. Liberia emerged from the civil war in 2003 with a tax-revenue-to-GDP ratio of 6.4 percent, among the lowest in the world. The tax base had been severely eroded by the granting of tax concessions, poor administration, extremely low tax morale, and widespread governance problems. Liberia was heavily dependent on trade and income taxes; the contributions of domestic sales and excise taxes were very small.

58. A major success of the TA provided in tax policy was an amendment to the tax code, the Consolidated Tax Amendments (CTA) to the Liberian Revenue Code, ratified in 2011. The CTA contained a clear investment policy, modifications to the customs and excise tax regimes, and a specified regime for the mining, petroleum and large-scale agriculture sectors. It improved significantly the transparency of the tax policy framework, and curtailed the discretionary provision of tax incentives in various codes and investment agreements with foreign investors.

59. The success of the CTA owes to strong leadership and momentum at the Ministry of Finance,[27] and sustained advice from the IMF, including legal drafting to help overcome capacity constraints. However, the institutional challenges for implementing the new act became quickly evident shortly after it was passed by the legislature.

60. Reforms in revenue administration began through addressing short-term actions to increase revenue soon after the end of the civil war. Starting in 2006, reforms included the re-design of the organizational structure of the tax administration, developing a new tax identification number, implementing an integrated tax administration system, establishing tax policy capacity in the Ministry of Finance, and building a comprehensive compliance program. As TA intensified under the multi-year program starting in 2012, Liberia demonstrated its commitment to tax reform by passing legislation to create a revenue authority, and a transition team was formed under strong

[27] The Ministry of Finance merged with the Ministry of Development Planning in 2013 and was renamed Ministry of Finance and Development Planning.

leadership. IMF TA focused on providing support to the design, transition and implementation of the LRA, in coordination with other donors.

61. Innovative delivery modes of intensive TA were required to support reforms through the travel restrictions in 2014, brought on by the Ebola outbreak. TA was delivered remotely through electronic modes to include face to face Skype sessions. Once the Ebola crisis subsided, a long-term expert was embedded with the LRA to guide the reforms on the ground as in person short-term expert assignments were re-established. Intensive assistance was provided to set-up the new LRA to include establishing the organizational structure with a taxpayer service and functional offices segmented by taxpayers; establishing a strategic plan and accountability framework; and compliance enforcement.

62. Despite adversity, the LRA opened its doors on July 1, 2014, at the height of the Ebola crisis. Supported through intensive FAD TA, the LRA now operates under a new accountability framework with a strategic plan in place; taxpayers are managed by segments; and the LTO along with the medium, small and micro departments, are functional. LRA employees are recognized as professionals, and jobs at the LRA are regarded as rewarding and career promising, and continue to attract Liberians from abroad. The fundamental facilities are in place to assess and collect revenues, and a taxpayer service unit has been established.

63. However, the shift of resources to operationalize the new organization left gaps in fundamental tax reforms. The focus on the LRA also shifted resources away from tax policy planning and implementation capacity at the Ministry of Finance, hampering ongoing domestic revenue collection efforts in the short term. IMF TA is now focusing resources on aligning business processes to optimize operational procedures, and improve the integrity of the registration and taxpayer account databases to support effective compliance management. In addition, Liberia is focused on implementing e-filing and e-payment and considering expanding the Goods and Services Tax to a VAT system with a broader tax base. The LRA has emerged as a major player in the government to help facilitate a strong economic recovery in Liberia.

Expenditures

64. Basic infrastructure was destroyed during the civil war, and hampered day-to-day functions. The Ministry of Finance's building lacked windows, office furniture, equipment, and an automated reporting system. Lack of electricity supply necessitated the use of expensive generators. Staff capacity was limited due to lack of training and low wages—the average salary was only equivalent to US$50 a month—and could not attract skilled staff.

65. The IMF initial needs assessment mission in 2003 highlighted Liberia's fragility across all PFM Institutions. The legacy issues of rationalizing the salaries of teachers—often paid by donors at much higher rates than the rest of the public service—had to be addressed as a priority along with cleaning up the wage bill. Commitments control and cash management practices were lacking, there was a backlog of unaudited financial statements, and the legal framework was outdated. Prior to independence, budget formulation was fragmented between the Bureau of

Budget—located in the Office of the President—and the Ministry of Finance, resulting in duplication of budget formulation functions. Moreover, the separation of the capital budget from the recurrent budget compounded the fragmentation, further limiting the presentation of a comprehensive annual budget. These areas were subject to conditionality in the 2006 IMF-supported staff monitored program.

66. The GEMAP was considered inadequate as it did not recognize the authority of the newly appointed Minister of Finance to approve payments, but rather assigned this responsibility to international experts. To allow the government discretion to manage its own payments, officials found creative ways to circumvent the co-signatory authority for all payments exercised by international experts.

67. Despite these difficulties, progress was made in some important PFM areas. The PEFA scores showed improvement between 2007 and 2012 in monitoring of expenditure arrears, comprehensiveness of the budget, recording of cash balances, debt and guarantees, effectiveness of internal audit, and timeliness of audit reconciliation. In addition, the implementation of a Poverty Reduction Strategy Plan, implementation of a PFM Act in 2009, enhanced transparency in procurement, merger of the Bureau of Budget and Ministry of Finance, development of a debt management strategy, and auditing of pilot ministries met the requirements of the HIPC completion point, signaling debt relief from multilateral and bilateral lenders and improved relations with them.

68. Progress in other areas—particularly on the TSA, medium-term expenditure framework, and full implementation of the integrated financial management information system—has been less pronounced. Successive Fund-supported programs included structural benchmarks to target these priority PFM reforms, but benchmarks on cash management and implementation of the TSA have not been met.[28] It is likely that these benchmarks were too advanced for the country capacity, and the lack of progress could be partly attributed to the poor working relationship between the Ministry of Finance, the Central Bank, and other ministries and agencies. Moreover, continuous failure of the Legislature to approve the budget on time, contributed to under spending, especially on public investment projects.

69. Through the implementation of new TA approach starting in 2012, PFM reforms were progressing well until the shock of the Ebola crisis in early 2014, which caused a renewed setback. TA delivery was stalled until travel restrictions were lifted. The TA approach was further refined after the Ebola crisis, to respond to concerns from Liberian officials about the human resource implications of the intensity of TA. A seminar to officials from various government ministries helped to reprioritize reforms and address remaining program benchmarks. This initiative was highly rated by officials and identified commitment control, fiscal reporting, cash management, the TSA, and public investment management as priority areas. The seminar discussed concerns raised in a General Audit Commission report regarding procurement irregularities in public investment management and the lack of accountability by the Ministries of Public Works and

[28] The PRGF program was in effect from 14 March 2008—13 March 2011 followed by an ECF program from 19 November 2011 – 18 November 2014.

Transport. The list of IMF recommendations was agreed by the authorities, thus signaling a new level of ownership.

D. Lessons Learned

- The nature and pace of reform in fragile contexts can be slow or reactive to immediate needs, and sometimes stop altogether in moments of crisis. In such circumstances, reform can be sustained through properly sequenced and innovative TA approaches, championed by strong leadership in the government.

- The combination of diagnostic TA followed by focused hands-on short-term assistance, and dedicated training, complemented by resident long-term advisors, enabled the IMF to adjust its capacity development priorities as circumstances and needs changed. This was evidenced, for instance, through the legal drafting assistance for tax policy, the combination of in-country and international training in PFM, the sequenced reforms to address debt reduction, and the delivery of remote TA during the Ebola crisis that led to the implementation of major reforms.

- Establishing a new organization like a revenue authority, can divert limited resources and slow reform. While this was a success, it came at the cost of revenue mobilization efforts at the Ministry of Finance, and delays in laying the fundamental foundations of tax administration such as the reliability of the taxpayer register, reconciliation of taxpayer accounts, and tax arrears management. This emphasizes the need to focus on the basic building blocks of tax administration, while sustaining the reforms that have been achieved thus far.

- Coordination of donors in the same assistance space is critical to success as seen in revenue administration. There has been some lack of coordination in PFM, including duplication of efforts and failure to prioritize needs, which may have contributed to the lack of progress in addressing basic PFM requirements, due to the focus on advanced reforms including implementing an integrated financial management system.

- Strong and consistent leadership from the President, enabled Liberia to launch its revenue agency in 2014. This is in stark contrast to PFM where significant TA support has resulted in slower progress over time.

MALI[29]

A. Background

70. Mali's GDP per capita ranks among the lowest in Sub-Saharan Africa. The country has tremendous needs in development, especially outside the capital city and in remote areas. Mali has

[29] Prepared by Jean-Luc Helis, Oana Luca, Stephane Schlotterbeck, and Benoit Taiclet.

been under lending arrangements with the Fund since 1995—the latest program was a PRGF from 2008-11, followed by an ECF from 2012-17.

71. Mali has long been considered a stable democracy with peaceful political changes. However, a growing insurgency and rise in terrorism in 2011, caused thousands of civilians to flee from the country's northern hinterland—a severe drought added to the economic and human costs of this migration. In 2012, fueled by popular resentment about Malian military setbacks, an ill-fated coup d'état toppled President Touré. Under international pressure, the self-declared junta opened a two-year transition period (2012-13), which was marked by various adverse occurrences, including: political instability; continued military operations led by an international coalition in the North; a sharp decline in economic growth and government revenue; and further deterioration of Mali's financial position with creditors. The period ended with the election of President Keita in 2013. A peace agreement was signed in June 2015 with northern insurgents. A new phase for fiscal decentralization kicked off in 2015 with the aim to improve development and opportunities in rural areas.

72. In the wake of the 2012-14 crisis, landlocked Mali was among the 10 poorest nations of the world, one of the 37 HIPC, and a major recipient of foreign aid. Mali's economic performance remained fragile, vulnerable to climatic conditions, fluctuating terms of trade, and dependence on neighboring countries. Ranked in the second decile of most FS,[30] Mali had to cope with serious challenges: massive migration; uneven economic development between rural and urban areas; and fragile security situation that undermines the government's efforts to strengthen the rule of law and deliver basic public services, including health, education, and humanitarian assistance, especially in the North of the country.

B. Technical Assistance Approach

73. TA to Mali has been delivered through a mix of long-term and short-term assistance from IMF headquarters and the IMF Technical Assistance Center for West Africa (AFW).

C. Key Issues and Outcomes

74. Malian authorities have made constant strides, albeit to limited avail, to abide by West African Economic and Monetary Union (WAEMU) surveillance criteria, and implement the WAEMU legal framework for transparency, tax, customs and public finance management. IMF TA focused on taxation frameworks, customs and tax administrations, and PFM framework, with interest in cross-cutting issues related to fiscal decentralization.

Revenues

75. Tax revenue in percent of GDP has been low, averaging 12 to 15 in recent years, well below the WAEMU convergence criteria of 17 percent—recently increased to 20 percent—like

[30] As of 2016, per the Fragile States Index (formerly the Failed States Index) of the think-tank Fund for Peace.

the average in low-income countries (about 14 percent). The tax administration is facing recurring weaknesses, including: poor tax compliance for medium and small-sized taxpayers; large informal sector; and significant tax arrears, indicating low payment compliance and poor collection capacity. The administrative problems have been compounded by several policy issues, including: generally complex rules; widespread tax preferences that take principally the form of temporary and permanent exemptions from key taxes; low-yield excises due to design flaws; and a complex system of fees and stamps that adds nuisance to the tax system and complicates administration, but yields little revenue.

76. The 2012-14 crisis has had a minor impact on revenue collection, due to the resilience of the tax and customs departments. The forced closure of offices in the northern regions accounted for less than 0.5 percent of domestic taxes; and few medium and large-sized taxpayers experienced disruption in their activities. The March 2012 coup was accompanied by the sacking and pillaging of the Direction Générale des Douanes (DGD), numerous customs bureaus, including IT systems and vehicles. Imports that had continued to grow till 2012 were held back by weakening domestic demand. This mainly reflected the impact of the Economic Community of West African States (ECOWAS) embargo and the conflict in the North of the country, which compelled the administration to move personnel to the South. In this extremely critical context, the DGD acted to ensure continuity of operations and the collection of duties and taxes: it opened temporary bureaus, implemented procedures manuals, and installed a backup server.

77. In tax policy, the IMF advised on general tax reforms and on mining and petroleum fiscal regimes. Following this advice, the 2015 Finance Law simplified the taxation of small taxpayers by establishing a synthetic tax of 3 percent of turnover, replacing 288 taxes. A new Petroleum Code was promulgated in July 2015. Amendments to the Mining Code were also drafted in parallel with the Petroleum Code, but their adoption has been delayed. To increase transparency in the mining sector, the government published all mining and petroleum contracts on the Ministry of Mines' website. TA contributed also to capacity building. In June 2015, a newly created inter-ministry unit in charge of mining taxation was trained in financial modeling and fiscal regime analysis using the Fund's Fiscal Analysis of Resource Industries (FARI) methodology. However, further support is needed to enhance the capacities of this unit.

78. Despite the political and security crises, the authorities continued improving the tax system. In 2012-16, tax revenues increased from about 12 percent to 15 percent of GDP. Progress included an increase of 26 percent in the number of large and medium-sized taxpayers, and an increase in their filing rate from 70 to 95 percent. This, in turn, contributed to a stronger VAT performance, from 4.9 percent of GDP in 2013 to 5.3 percent in 2015.

79. The key objectives in the medium term are to speed up tax policy reforms. This should happen through broadening the taxable base of major taxes, further streamlining nuisance taxes, reducing the disincentives to the labor market caused by very high labor taxes, and improving the design of property taxes and the taxation of the telecom sector. Also, the country needs to develop a compliance strategy with a stronger focus on simplification, increase audit coverage to address possible risks related to VAT credit claims, enhance the monitoring of tax arrears, upgrade the IT system to automate most of the processes, and avoid imposing unjustified penalties on taxpayers, introduce performance management as part of a broader strategy to improve human resource policies and practices.

80. FAD's advice on customs administration has focused on several recurrent strategic issues, including the best way to secure and facilitate procedures in a landlocked country environment, a recommended move from inspection services by private providers and correlative strengthening of internal capacities; and an adequate redeployment of staff to high value-added functions. At the regional level, AFW has provided TA on risk management, which is key to increased control effectiveness. Delayed by the 2012-24 crisis and the upgrade of the IT system, the project is still underway.

Expenditures

81. The Mali PFM system has been revamped twice to comply with WAEMU standards. A first reform in the late 1990s to align accounting and budget practices with international standards, and, since 2009, a second set of reforms has been implemented to improve cash management and move toward second generation reforms (e.g., computerized accounting, expenditure processing, cash management, and public investment management).

82. The current PFM system is marked by uneven performance and low accountability. Although the system compares well to other Sub-Saharan African countries, in the areas of budgeting and treasury management (both areas being covered by IMF TA), the system presents the following weaknesses: i) weak fiscal discipline, notwithstanding progress made since 2014 to settle past expenditure arrears and avoid accumulation ones; (ii) derogatory procedures for spending hamper financial reporting; (iii) frequent delays, and use of restricted procedures in procurement; and (iv) little impact of audit and parliamentary scrutiny on financial accountability. These weaknesses contribute to the perception of still weak governance as reflected in Mali's low ranking on the transparency International corruption perception index (127 out of 175 countries in 2013, although improving in 2014–15), and breaches in financial integrity during 2013 to 2015.

83. Major weaknesses in accounting, treasury operations and financial governance are being addressed before moving toward second generation reforms such as program budgeting and new accounting standards in 2019. In this context, TA has focused on core PFM functions to lay a sound basis for the second generation reforms, with additional TA provided by AFW on implementing the WAEMU directives (e.g., program budget and chart of accounts). Other donors are also involved in external audit (European Commission and Canada), subnational government capacity strengthening (Canada and Switzerland), and procurement (WB).

84. With this assistance, the authorities have almost completed transition to the TSA. They have adopted measures to enhance budget transparency and improve the presentation of Mali's fiscal accounts. Notable progress has been made towards submitting the draft finance law under the program budgeting format and presenting the government consolidated fiscal transactions based on the *2001 Government Finance Statistics Manual (GFSM 2001/2014)*, starting in 2018. Finally, the Public Procurement Integrated Management System will be adopted by all ministries in 2017.

Fiscal Decentralization

85. The long-established process for decentralization in Mali has delivered mixed results over the years. In 2013, after two years of armed insurgency and political instability, the issue of decentralization became the center of a heated debate within the peace talks between the central government and northern insurgents. The Malian administration is now envisaging scaling up fiscal transfers to local governments to the tune of 30 percent of the country's budgetary revenue by 2018.

86. However, regionalization entails several risks that the country is ill-prepared to manage. These include poor governance of local finances, insufficient revenue flows to local budgets, and ineffective local policies with little economic and social impact.

87. In 2014 and 2015, the IMF provided extensive TA on how to address some of these risks from the outset. These included sharing of taxation powers between the central government and the regions, an equitable and efficient transfer system to local governments, strengthen local governance through strong accountability, and capacity building and training for local officials.

88. Fiscal decentralization remains central to the peace agreement. The authorities have prepared a three-year strategy to boost regional development projects; and accompanied subnational governments in their budget execution, while providing training and TA to local administrations. The IMF's role in engaging directly with local governments has been very thin in general, due to resource constraints. But other donors are keen to help (e.g., Switzerland and Canada), focusing primarily on capacity development of local government administrations.

D. Lessons Learned

- TA should resume quickly after an armed conflict. The IMF resumed its TA to Mali as soon as the security situation allowed it, which helped in mobilizing commitment from the authorities and interest from bilateral and international donors.

- Effective coordination is key to progress. Within the IMF, collaboration across various departments was efficient, with the African department playing a leading role. The IMF also led coordination efforts with other donors and international organizations, which proved effective in channeling TA to the most critical areas of fiscal management, and show progress relatively quickly.

- Focus on clearly-identified basic needs. As a first stage after a political and security crisis, and a fragile peace agreement, it is important to stick to the basics, and find quick solutions to address them. In Mali, these included improving cash management, financial integrity, and supporting the early stages of fiscal decentralization. This has helped in reaching basic milestones and outcomes, consistent with the country's absorption capacities.

- An up-to-date plan on needed reforms is always necessary. In FS like Mali, reforms implementation can be erratic due to political economy, security, and capacity factors. In such environment, it is always an advantage to have an up-to-date reform plan at the level of key fiscal institutions, so that opportune moments for reforms can be seized quickly and effectively.

MYANMAR[31]

A. Background

89. Myanmar adopted a new constitution in 2008, and embarked on substantive fiscal reforms after an isolation of many decades. The parliamentary authority over public finances was restored, central and local governments' budgets and funds were separated, the Central Bank of Myanmar (CBM) was granted autonomy and state economic enterprises were granted greater financial autonomy. The tax-to-GDP, at 6.3 percent in 2012, was among the lowest in the world. The government offices and most of the business community used manual procedures and modern revenue administration and public financial management practices were largely unknown.

B. Technical Assistance Approach

Revenues

90. The IMF assisted Myanmar in developing a tax reform strategy, and a large multi-year TA program was set up to assist the country in executing the strategy. Assistance has consisted of headquarters missions, specialist short-term expert visits, and a full time in-country resident tax administration advisor. This program allowed the IMF to provide strategic guidance on the changes needed, as well as operational guidance on how to implement those changes.

91. Although the large share of the TA program focused on tax administration, a tax policy component was added in 2016. There are three objectives for this component: (i) build capacity for developing and analyzing policy options; (ii) provide advice on how the tax system should evolve over the medium-term to meet the country's tax revenue needs; and (iii) ensure that the operational reforms of the tax administration are geared toward building a modern, yet simple tax policy framework.

92. The strategy for tax reform and the TA provided focus on the medium term. It includes coordination with other key donors, who has provided downstream assistance in their specialty areas, particularly the WB and the US Treasury Office of Technical Assistance.

[31] Prepared by Sandeep Saxena and Margaret Cotton.

Expenditures

93. The IMF has provided a series of TA missions to develop the broad framework for reforms in the medium-term. In parallel to this medium-term view, immediate reforms were also needed and identified. TA focused on building core PFM capabilities, with the following early priorities: (i) strengthening the budget formulation process; (ii) separating budget and treasury functions to allow faster development of the latter, particularly with the aim of moving toward a more transparent market-oriented cash and debt management, while reducing the central bank financing of budget; (iii) enhancing financial reporting and improving its timeliness; and (iv) modernizing the financial regulations to provide a firmer footing to the changes.

94. The Director General of the Budget Department provided the lead in formulating a coherent reform strategy. A PFM Reform Group, headed by the Director, and comprising all major development partners, was established. Recognizing the need for a coordinated approach, while reducing administrative burden and costs, Partnership Principles to guide inter-partner and partner–government coordination modalities were formalized. The Group, with active participation from senior officials of the Ministry of Finance, provided a forum for collaborative action, and played a key role in the formalization of the government's reform strategy. The strategy identified key reform actions and the development partner expected to lead TA in each of the identified areas.

95. The IMF TA included a Bangkok-based regional advisor, who visited Myanmar almost every month. The advisor was supported by peripatetic experts for specialized inputs. A series of training workshops were conducted to build awareness and skills. The advisor played a critical role in advising the authorities, training, and mentoring staff of the new Treasury Department, and in establishing coordination mechanisms involving other major stakeholders, such as the CBM and Myanmar Economic Bank, the state-owned commercial bank responsible for providing banking services to the government. The IMF also coordinated with other development partners, particularly the Asian Development Bank that provided complementary TA in improving debt management.

C. Key Issues and Outcomes

Revenues

96. The tax administration reform strategy focused initially on larger taxpayers, to secure a large percentage of tax revenue and allow progressive institutional strengthening. The strategy aimed to broaden the tax base, by both increasing the number of registered taxpayer and improve compliance with tax obligations, while minimizing the cost of complying with those obligations. This is expected to prepare the tax department and larger businesses for longer-term tax policy reforms.

97. Myanmar has made tangible progress in several tax administration areas, primarily due to leadership commitment. These included: organization and procedure redesign, program governance, performance measurement, integrity initiatives, and capacity building for staff and businesses. Since 2012, revenues from major taxes (commercial tax, income tax) have increased on average over 20 percent year-on-year and the tax-to-GDP ratio is now over 8 percent, a slight improvement over 2012. Compliance by large taxpayers with core tax obligations of registration, and on-time filing and payment is high, and a tax procedures code has been drafted.

98. Tax policy reforms to broaden the indirect tax base have begun. With some improvement in administrative capacities, the country is better positioned to review the major taxes, and contemplate new ones.

Expenditures

99. Weaknesses existed in almost every aspect of PFM. The 2013 PEFA assessment assigned a "C" or "D" rating to 26 of the 30 performance indicators. The largely incremental budget formulation process was incapable of allocating resources to the emerging government policies. The treasury management function was rudimentary—budget deficits were routinely monetized contributing to macroeconomic instability; and more transparent and market-oriented procedures for cash and debt management were needed to be carried out with a more strategic perspective. The financial reporting was incapable of meeting the increased demand from the legislature, the decision-makers, and other stake-holders. The financial rules and regulations were procedural in nature and outdated. The lack of automation impeded the efficiency and capability of the system, besides putting tremendous burden on the staff. The system needed modernization to enhance its capabilities to meet the new challenges.

100. On the positive side, there was willingness to reform both at the political and operational levels. The budget execution process was decentralized—with basic checks and balances present—and accounting comprehensive in its institutional coverage. The data carried in the financial reports was meticulously compiled, accurate and reconciled, although deficient in content.

101. Some key institutional reforms were implemented in a well-structured and gradual approach. In 2014, the government established a new Treasury Department, structured along the lines of a modern treasury, and a system of faster (weekly) settlement of government funds with CBM was introduced. In 2015, the government commenced auctioning treasury bills, and a top-down approach to budgeting was introduced in the formulation of the 2015-16 budget. New more reader-friendly formats are ready for adoption in the 2016-17 annual financial statements. Revisions to the 1986 Financial Rules and Regulations are being finalized, and at the initiative of the new government, an organic PFM law is under development.

D. Lessons Learned

- The early success in the Myanmar TA program reflects leadership commitment and willingness to learn from international good practice.
- Centralized authority means relatively slow decision-making and response to TA recommendations, but ensures wider compliance once a decision is taken.

- Early successes prepare the ground for sound and responsive fiscal institutions. A graduated approach, building successive coherent layers of increasing sophistication, is more likely to succeed.

- Continued political commitment is a challenge since reforms will likely spread across several political cycles. It is therefore important to build wider political convergence on reform priorities and show tangible results/quick wins along the entire reform process to keep momentum and encourage reforms to move forward.

SOUTH SUDAN[32]

A. Background

102. South Sudan is a FS with acute challenges. It ranks among the least developed countries in the world and scores very poorly on almost all SDGs indicators. Since it attained independence in 2011, institution building and development have been hindered by volatile relations with Sudan that resulted in a 15-month shutdown of oil production, and three-year civil conflict that started in December 2013.[33]

103. Real GDP growth has been negative in all years since the country's establishment, except for 2013/14. Real GDP is estimated to have declined by about 7 percent in 2015/16—reflecting lower oil production and a subdued non-oil sector—and is projected to further shrink by 10½ percent in 2016/17. Moreover, falling oil proceeds have hampered fiscal revenue, leading to an unprecedented acceleration in borrowing from the central bank, which in turn, pushed up to about 550 percent in 2016, and caused a sharp depreciation of the exchange rate.

104. CPIA scores are very low and have deteriorated since independence. This was especially the case in fiscal policy, public sector management and institutions, quality of public administration, and transparency, accountability and corruption in the public sector. The civil conflict and economic crisis contribute to the persistence of extreme poverty in certain regions and large displacements of civilians and refugees. The extreme dependence on oil production, price uncertainty, finite reserves, and volatile revenue flows, also present complex challenges and underscore the importance of developing the non-oil economy.

B. Technical Assistance Approach

105. The IMF has followed a coordinated approach to TA delivery, with many players. In this regard, and leveraging its technical know-how and financial resources of development partners, the IMF set up the multi-donor South Sudan Trust Fund (SSTF) shortly after independence to finance TA

[32] Prepared by Miguel Angelo Alves, Diego Mesa-Puyo, Andrew Kazora Okello.

[33] A civil conflict erupted late 2013. Following the establishment of a Transitional Government of National Unity in April 2016, the country relapsed into violence in July 2016.

and training in many areas, including revenue mobilization and PFM. IMF assessment missions have guided the authorities and development partners on the ground on reform priorities and critical next steps. This was complemented by hands-on mentoring, coaching, and training in selected areas.

C. Key Issues and Outcomes

Revenues

106. The fiscal challenges faced by South Sudan are compounded by lack of adequate capacity in many areas of revenue policy and administration. First, the country lacks the capacity to administer taxes that were previously collected at the national level by the former Sudan Government of National Unity (GoNU) institutions.[34] Second, while GoNU laws no longer have legal force in South Sudan, equivalent laws or transitional provisions have not been promulgated (at independence) for South Sudan to administer these taxes. Third, capacity to develop policy options and draft legislative amendments both within the Ministry of Finance and Economic Planning (MoFEP) and the Ministry of Justice is very weak. Fourth, the revenue administration directorates, the Directorate of Taxation and the South Sudan Customs are infant institutions with weak skills and management capacity, and have been heavily supported by development partners.[35]

107. IMF TA has focused on non-oil taxation, since a 2010 mission found the fiscal regimes governing most of the oil contracts inherited by South Sudan, with the notable exception of the pipeline charge negotiated with Sudan, to be in line with good international practice. Advice has helped design comprehensive reform strategies that have guided reform implementation in the last six years.[36] Pragmatic advice in the area of tax policy has focused on implementation of simple tax regimes, including the following measures: (i) passing urgently required tax and customs legislation to provide the mandate to collect taxes and duties from a much wider base; (ii) implementing a 5 percent manufacturer's sales tax applicable domestically and to all imports, with limited exclusions; expanding the number of excisable items; and (iii) implementing PIT at the subnational level that piggybacks on the national PIT and that is collected and distributed by the national government. Recommendations in revenue administration have focused on high impact priority areas, such as (i) establishing the basic infrastructure in the key compliance management functions; (ii) strengthening the large taxpayer unit and customs operations at the largest port to secure the largest proportion of tax revenue; (iii) transferring of the customs administration from the

[34] Under GoNU laws, business profits tax from large businesses, value added tax, and customs duties were administered at the national level.

[35] Major development partners and technical assistance providers included DfID, German Agency for International Cooperation (GiZ), USAID/Deloitte Consulting LLP (Deloitte), Trade Mark East Africa (TMEA), the WB, and Japan International Corporation Agency (JICA).

[36] An IMF revenue policy and administration diagnostic mission was fielded a month after independence (August 2011). However, the IMF involvement in the GoNU, including review of the operations in the South, was sustained before independence. A mission was also fielded within one month of the establishment of the Transitional Government of National Unity to recommend measures with quick revenue impact and follow up steps for reform and capacity development.

Ministry of the Interior to the MoFEP; and (iv) implementing simple procedures and automated systems.

108. In addition to the challenges of a nascent state, South Sudan has faced additional external shocks, including the sharp fall in commodity prices observed since 2014. Donor support has also dwindled due to internal conflict and political instability. However, "green shoots" of reform progress are visible, and IMF advice has been implemented in key areas, including in tax policy. Some of the notable measures implemented include (i) a simple 5 percent sales tax regime adopted in 2012, subsequently increased to 15 percent in 2014/15 and to 18 percent in 2016/17; (ii) excises levied on selected goods and services, and an increase in excise rates over the years to address dire revenue needs; (iii) advance payment of income tax on imported goods is now charged at 2 percent for food, and at 4 percent for all other goods; and (iv) a simple business profit tax regime based on the size of business.

109. In the area of revenue administration the following measures have been introduced: (i) basic infrastructure and institutions have been set up, including new offices and computers; (ii) tax and customs laws and regulations have been enacted; (iii) administrative procedures have been put in place for taxpayer registration, collection enforcement and audit (about 50 audits were completed in 2015 compared to zero in 2011); (iv) a viable large taxpayer unit has been set up and operations at the largest border post improved; and (v) basic information technology systems have been implemented.[37] Non-oil tax-to-GDP has grown from about 1 percent of GDP at independence to about 4 percent in 2015/16, but the potential remains largely untapped.

110. Going forward, several measures could help the long road toward normalcy and transition from fragility. In the revenue area, developing capacity of states to collect their own-revenue is key to establishing viable subnational governments, especially given the ethnic tensions in the country. Other measures include renegotiating with Sudan the exorbitant pipeline charges to transport oil, reforming the exemptions and incentives regime, professionalizing revenue administration, and reducing corruption. The proposed National Revenue Authority can aid this process, but this must go hand in hand with strengthening tax and customs operations, and the appointment of management and staff with the requisite experience and skills. The large number of inexperienced staff, particularly in customs (former combatants) presents a major challenge that will need to be addressed judiciously.

[37] It is important to note however that implementation of the reforms has been painstakingly slow and at times the reform measures have not been implemented fully. For example, despite adoption by Parliament and signatures by the President, the new taxes have not been implemented immediately.

Expenditures

111. PFM institutions were nonexistent or extremely weak in the wake of the country's independence. The existing PFM systems, gradually put in place in the aftermath of the Comprehensive Peace Agreement in 2006, were only partially implemented and not sufficiently consolidated, and most of the senior government staff were drawn from the diaspora, with little PFM experience. There was no systematic budget planning or policy development taking place, and ad hoc decisions were taken to use surplus oil revenues for expansion of government activities and progressive increase of government expenditure. Further, there were no in-year and end-of-the-year fiscal reports/accounts to inform decision making and enhance transparency and accountability, including in the use of oil revenues, and the FMIS, implemented before independence with assistance from donors, was used only for ex-post recording of transactions.

112. Between independence and the start of the civil war in 2014, IMF PFM TA focused on setting up and supporting a strategic reform process. Considering the very weak starting point, the development partners forming the SSTF Steering Committee agreed to the IMF taking the lead in assessing the PFM status and assisting the authorities in identifying the priority reforms and developing a medium-term strategy to build the necessary institutions. To that effect, the IMF conducted an initial diagnostic mission in August 2011 and assisted the authorities in setting out the action plan on priority reforms, which were identified to be budget execution control, accounting/reporting systems, macro-fiscal analysis, and budget planning and preparation. The mission also focused on the coordination and management of the reform process. Two follow-up missions in August 2012 and November 2013 reviewed progress and provided further advice, including through capacity building workshops, in areas where progress had been slower.

113. The TA, complemented by more permanent, on-the ground support from advisors of other development partners, contributed to progress in the PFM area over the three-year period, albeit slow and somewhat timid. The main achievements included approval of key PFM legislation, greater focus on budget control, processing of transactions through the FMIS, preparation of a draft Petroleum Revenue Management Bill with an oil benchmark price-based fiscal rule, a new budget preparation system in spending agencies, launching of a survey of government bank accounts, and preparation of quarterly reports comparing budget estimates and outturn.

114. The nascent PFM institutions and routines largely broke down during the economic and political turmoil of the past two years, however. In the context of dwindling revenue, spiraling inflation, and the pressures of armed conflict, the early reforms were undermined or simply reversed. Highly unrealistic budgets became the norm; financial controls were lifted or circumvented; control over payroll was lost; payment decisions became ad hoc and based on nontransparent criteria; expenditure arrears rose exponentially; revenues were retained by collecting agencies; and civilian agencies were left without resources to maintain normal operations let alone undertake needed investments. During this period, TA from the IMF and most other development partners was also discontinued.

115. The setting up of the Transitional Government of National Unity in April 2016 allowed TA activities to resume, albeit briefly.[38] The new engagement aimed primarily at reestablishing core routines, enhance transparency, and strengthen the integrity of the system, which external donors set up as pre-conditions for further support. An IMF mission in May 2016 identified the most urgent PFM reforms required in three broad areas: budget preparation, budget execution, and fiscal reporting and recommended actions that: (i) are critical to the basic functioning of and trust in the PFM system, (ii) are implementable in the coming 18 months, and (iii) demonstrate to domestic and international stakeholders the government's full engagement in the reform process.

116. Going forward, appropriate sequencing and TA delivery modes will be crucial for ensuring more effective and sustainable capacity building. Early support should focus on reforms with which the authorities can demonstrate to all stakeholders that the basic control systems (namely, realistic budgeting, transparent payment decisions, full and timely recording of government's cash inflows and outflows in the FMIS, integrity checks in fiscal reports, and interim audits) are in place. Only when these are consolidated, should the authorities engage in more ambitious reforms. While it is important to ensure predictability and adequate presence of TA experts on the ground, delivery of IMF TA should be subject to the authorities' commitment to implement reforms and providing adequate and suitable staff to act as counterparts.

D. Lessons Learned

- The South Sudan experience highlights three key lessons for the effectiveness of TA in an extreme fragility case, where the probability of returning to civil unrest and war remains high, as recent events have shown.

- First, the authorities should remain focused on the basics and fundamentals of simple policies and institution building, as there is always the temptation to do too much at the same time. In this regard, it is important to separate short-term actions that are necessary for the state to function, from longer-term institution building. The short-term measures advocated by the IMF, such as a turnover tax of 5 percent, has a significant and quick impact on government revenues. However, it was clear that without linkages to the longer term, such measures could become distortionary over time, and difficult to reverse—as was shown by the increase in the rate to 18 percent.

- Second, tight coordination of interventions from multiple donors and TA providers is necessary for success—indeed, lack of effective coordination could delay reforms and state building. Immediately after independence, there was a large influx of donors and development partners providing the authorities uncoordinated advice. The authorities were determined to implement ambitious programs such as setting up a National Revenue Authority, as provided for in the constitution, even though the basic foundations for effective tax and customs administration

[38] The worsening of security situation in July 2016 (missions to South Sudan have been suspended since July 2016), continues to undermine the impact of TA in South Sudan because of high staff turnover (fleeing the war) and the absence of resident advisors.

had not been put in place. Coordination between development partners allowed an integrated approach to TA delivery. For example, from the early stages of involvement, international organizations and the donor community set up an informal PFM working group (with representatives of the IMF, the WB, African Development Bank, European Commission, USAID, DfID, Embassies of Canada, Japan, Norway, UK, and USA) to coordinate TA efforts.

- Third, countries must address the challenge of recruiting a minimum of middle-management officials with the right competencies in various areas of public finance. These individuals would steer the reform process in coordination with donors, and act as trainers to other officials. This will undoubtedly improve the ownership and effectiveness of TA. This was clear, for instance, in the audit of large taxpayers, and enforcing controls on public expenditures.

TIMOR-LESTE[39]

A. Background

117. Timor-Leste is a lower-middle income country,[40] highly dependent on oil exports. Despite a move to lower-middle income status and restoring its basic infrastructure, which was largely non-existent before independence in 2002 and largely destroyed during the subsequent period of internal violence and political instability in 2006-2007, it is still a country with high poverty and a very young population—60 percent are under the age of 25.

118. In 2015, the oil sector generated 70 percent of GDP, 99.5 percent of exports, and around 90 percent of total revenues. The small non-oil economy is still largely based on subsistence agriculture, so Timor-Leste is a net importer of almost all the goods it consumes. Oil production is expected to decline and cease by 2023[41] unless new oil reserves are developed. Therefore, the country needs to prepare for a future with a diversified economy and additional revenue sources to sustain growth and to attain middle-income country status by 2030 as outlined in the Strategic Development Plan (SDP) 2011-2030.

119. The key policy challenge for Timor-Leste is to manage its petroleum wealth in a sustainable manner that stimulates the growth of the non-oil sector and reduces poverty. To reach the SDP goals, there is a need to further develop infrastructure which is essential to economic diversification and economic growth. Government capital spending increased from 2 percent of GDP in 2002 to more than 11 percent in 2010, and has since remained around 10 percent of GDP. This exceptional increase reflects the government's commitment to address infrastructure deficiencies,

[39] Prepared by Eliko Pedastsaar.

[40] Timor-Leste is classified as a lower-middle income country based on the GDP. However its development level is closer to low-income developing countries (LIDCs).

[41] The accumulated wealth in the Petroleum Fund was estimated at 16.2 billion US$ as of end 2015.

and was made possible by transfers from the Petroleum Fund in excess of the so-called Estimated Sustainable Income.

120. Since the restoration of independence in 2002, Timor-Leste has made significant efforts in implementing PFM reforms. The government has successfully implemented: an advanced and transparent framework for the governance of the petroleum sector, a well-managed Petroleum Fund, an efficient TSA, comprehensive and timely reporting and availability of key fiscal information to the public. Compared to an earlier PEFA from 2010, Timor-Leste has continued to make solid progress in strengthening its PFM systems. Improvements were measured in 9 of the 28 applicable PEFA indicators in the 2010–13 period, but half of the indicators are still assessed at or below "C" score in the 2014 PEFA. The last PEFA assessment pointed to several weaknesses in PFM systems and processes that have either remained unchanged or worsened since the 2010 PEFA. Low budget credibility is an indication that there is a limited capacity to prepare realistic and reliable budgets underpinning good fiscal management, responding to agreed policy priorities and being essential for long term fiscal sustainability. The management of expenditure arrears is in its infancy, oversight of autonomous entities (state owned enterprises) has not been established, internal audit is almost non-existent, budget planning and implementation capacity, especially capital budget, in line ministries are still weak and procurement processes have remained challenging with the open tenders still not a default method.

B. Technical Assistance Approach

121. The IMF has provided TA to the Ministry of Finance in Timor-Leste in many areas since the beginning of independence. In 1999, under the United Nations Transitional Administration, when phase one of PFM reforms started, the IMF provided the framework for the development of the CFA. The long-term strategy for setting up modern budgetary and treasury functions was also designed with considerable TA.

122. IMF support was instrumental in developing and reviewing the petroleum fiscal regime, preparing petroleum revenue forecasting, and refining existing macro-economic forecasting tools. In 2004, the IMF placed a resident expert in the Ministry of Finance to assist with the creation of a petroleum fund based on principles from the Norway model. Following the implementation of the petroleum fund, Timor-Leste moved to phase two of PFM reforms and the focus of IMF TA shifted to the broader improvement of the Government's financial management. In 2012, when a third stage in PFM reforms started, major structural reforms and change management took place in the Ministry of Finance and key PFM institutions. The support was provided through diagnostic missions, short-term expert visits and a resident treasury adviser from 2007 until 2013.

C. Key Issues and Outcomes

123. In the initial stage, the first element of the PFM reform strategy was to establish fiscal institutions in Timor-Leste by making the CFA operational. The CFA designed the overall fiscal strategy, formulated tax policy, administered revenue collection, and coordinated the public expenditure program. This step was followed by preparing the strategy for setting up modern budgetary and treasury functions. The initial emphasis was placed on the effective management of the country's substantial oil and gas wealth, including the creation of a Petroleum Fund and a comprehensive public investment program. The Petroleum Fund was created in July 2005 and its strong governance is one of the cornerstones of Timor-Leste's PFM system.

124. The focus of the work in the second phase, which started in 2006, was to help strengthen expenditure management, treasury operations and fiscal reporting, including advising on how to maintain fiscal discipline after devolving expenditure assignments to line ministries and subnational governments. In the first years, TA in the treasury area was related to: (i) strengthening institutional and organizational arrangements in the Ministry of Finance and line ministries; (ii) capacity building of Treasury staff; (iii) decentralizing treasury functions to line ministries; (iv) improving the financial management information system; and (v) modernizing the legal framework. Implementing a TSA was included in the IMF's TA program in 2008. In 2010 the IMF conducted two assessments (PEFA and a fiscal transparency Report on Observance of Standards and Codes) to consolidate and enhance ownership of a PFM strategy.

125. A new Budget and Financial Management Act (2009) developed under the leadership of the IMF's treasury advisor brought about greater transparency and accountability. The Budget and Financial Management Act, 2001 was drawn up during the time when the country was governed by the UN Transitional Administration. The amended Act promulgated in 2009 introduced discipline regarding the opening of bank accounts and government borrowing, defined a budget calendar, allowed the creation of special funds, regulated budget transfers, defined reporting and audit requirements, and stipulated penalties for various offences committed by civil servants.

126. After a successful TA program in treasury management, the IMF did not provide support to PFM reforms as many other donors had comprehensive TA programs. However, in 2016 the IMF provided an assessment of public investment management efficiency. The assessment identified weak links and proposed an action plan to improve the effectiveness with which Petroleum Fund resources are invested.

D. Lessons Learned

- Long-term resident advisors have been instrumental in setting up fundamental fiscal reform, such as the Petroleum Fund.
- Extremely low capacity may call for TA to substitute for local resources in the short term. For example, Australia Capacity Building Project and the WB PFM Capacity Building Project funded several important reforms, including many international advisors that in the first years of independence and after 2006 crisis were focusing more on the daily management of PFM functions than on reform or capacity building.
- In the medium to long run, however, the focus should move toward strategic planning and prioritization. This is what happened in 2012, when a third stage in PFM reform started, and the

Government became more selective of donor funded initiatives, making sure they are well aligned with its overall strategy.

- The sustainability of reforms requires constant efforts and improvement. While Timor-Leste is expected to graduate from the FS status in 2017,[42] the overall conditions in the country remain challenging and there are many potential risks to the PFM reform processes.

[42] According to the WB's Fragile State (FS) classification.