Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 19-Jun-2019 | Report No: PIDC27104

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Mozambique	P170840		MZ Public Revenue, Expenditure, and Fiscal Decentralization Enhancement and Reform project RE (P170840)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
AFRICA	Oct 07, 2019	Dec 20, 2019	Governance
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Ministry of Economy and Finances	Centro de Desenvolvimento de Sistemas de Informação e Finanças, Autoridade Tributaria	

Proposed Development Objective(s)

The proposed project development objective (PDO) is to enhance public financial management by strengthening (a) revenue mobilization, (b) expenditure management and control, and (c) fiscal decentralization.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	16.00
Total Financing	16.00
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	16.00
Miscellaneous 1	16.00

Environmental and Social Risk Classification	Concept Review Decision
Low	Track I-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

Mozambique's two decades of economic growth contributed to poverty reduction that was nonetheless accompanied by a widening gap between the better-off and the poor. Real gross domestic product (GDP) growth averaged 7.0 percent between 2000 and 2017, making it one of the fastest growing countries in Sub-Saharan Africa. Growth has been supported by sound macroeconomic management, several large-scale foreign investment projects in the extractive sectors, political stability, and large donor support. The economic expansion boosted incomes and living standards and placed poverty on a declining trend. By 2014, the poverty rate dropped to 48 percent from 59 percent in 2008. However, economic progress disproportionally benefited the wealthier segments of the population especially in urban areas. The annual consumption growth for the top quintile was nearly three times faster than growth rate of the bottom 40. This increase in inequality is captured by the Gini coefficient, which rose from 0.47 to 0.56 between 2008 and 2014, positioning Mozambique among the most unequal countries in sub-Saharan Africa.

This growth ended in 2015 with an economic downturn brought about by low commodity prices and a regional drought, which was then worsened by the disclosure of hidden loans in 2016. In 2016, revelations of US$1.4 billion (or around 11 percent of GDP) in previously undisclosed debt by two state owned enterprises, Proindindicus and MAM, led to a further decline in the economy as well as a freeze in donor budget support. This resulted in a reduction in GDP growth from 7.4 in 2014 to 3.8 percent in 2016 and a rapid depreciation of the metical (the local currency) by 36 percent against the U.S. dollar. Inflation averaged 20 percent in 2016, with food price inflation reaching 32 percent, making the economic downturn felt disproportionally by the poor. The additional debt and ensuing currency depreciation also implied a sharp increase in debt service obligations, adding a further two percent of GDP in debt service per year while the stock of public sector debt-to-GDP reached 128.3 percent at the end of 2016. Higher debt service, lower donor support, and a lack of room for borrowing significantly shrunk the country's fiscal space.

Despite some recent progress since 2016, Mozambique's fiscal outlook remains fragile. While signs of macroeconomic stability have emerged, reflected in a relatively stable metical, a decline in inflation, increased exports, and the development of a major gas project in the Rovuma basin pipeline, the country shows reduced capacity for growth. Real GDP growth decelerated to 3.7 percent in 2017 and is expected to remain relatively flat at around 3 percent in the medium-term. Fiscal adjustment efforts to address the heightened fiscal deficit (accounting for 8.2 percent of GDP in 2017) have focused on reduced spending, particularly in public investment and in the shoring up of revenues. Payment arrears and a growing domestic debt reflect Government difficulties to finance its budget deficit. Debt levels have also remained unsustainably high with several external borrowing payments missed.

With spending pressures in view, some of the main challenges for the Government are improving economic governance, fiscal management, and public accountability. The debt crisis ha surfaced a number of governance challenges facing Mozambique—namely debt management, public investment management (PIM), and lack of oversight mechanisms for state-owned enterprises (SOEs)—and generated a more general crisis of confidence in Government's fiduciary capacity. Meanwhile, increased fiscal pressure expected from the emerging decentralization arrangements accompanying the peace agreement will require the creation of more fiscal space by focusing on improved revenue mobilization, greater efficiency of spending, appropriate fiscal decentralization arrangements, and enhanced subnational PFM institutions and performance at the national and subnational levels. For this, PFM reforms need to be advanced to ultimately make the state less vulnerable, more effective, and more accountable to citizen's and taxpayer's needs.

Sectoral and Institutional Context

In 2016, the Government developed a medium-term PFM reform strategy and action plan to address the country's challenges of fiscal transparency, risk, and budget management. The PEFP (2016-2019) is aligned with the government's Vision of Public Finances (2011-2025) and the Five-Year Program of the Government (PQG). The PEFP provides a broad coverage of public finance issues, broken down into seven objectives, and a set of sub-objectives or activities. This Strategy has set the basis – as well as a platform – for ongoing dialogue between development partners and the (Government of Mozambique) GoM around coordinating, aligning, and monitoring PFM reforms.

Recent reforms have focused on addressing PFM challenges that have emerged from the 2016 debt crisis and planning and budgeting. Since 2016, much of the reform effort has focused on strengthening fiscal transparency and risk management in view of the hidden debt revelation. Some key achievements include the preparation and progressive implementation of numerous strategies addressing the clearing of arrears, anti-corruption, the adoption of an SOE law for public debt, and the strengthening of fiscal risk management. It is also noteworthy that progress has been made in validating and clearing the stock of arrears accumulated by end 2017, though emerging evidence has revealed that substantial new arrears were generated in 2018. A series of planning and budgeting reforms have also been initiated to strengthen the link between plans and budgets. Progress has been made in strengthening GoM's program-based budgeting through the development of tools and carrying out of consultations on newly defined programs. The Ministry of Economy and Finance (MEF) set up an intra-departmental working group—the Subsystem of Planning and Budgeting (SPO)—to unify planning and budgeting instruments and processes and to develop a single Module of Planning and Budgeting (MPO) within the integrated financial management system (e-SISTAFE). On the budget execution side, reform efforts have focused on procurement legislation and boosting capacities to better promote transparency and competition. A key initiative currently focuses on the preparation of an electronic procurement system, the so-called *Modulo do Património do Estado* (MPE), which is expected to increase efficiency, reduce losses, boost competition, and address fraud and corruption.

Domestic revenue mobilization and management has improved significantly in Mozambique over the past several years. A new tax regime was introduced for mining and petroleum, in response to the discoveries and exploration of significant oil and gas discoveries, particularly in the North; with this, an Extractive Industries Tax Unit (UTIE) was established within the AT. A simplified tax regime for small contributors (ISPC) has been introduced to replace a number of existing taxes for small businesses. Most significantly, an automated revenue management system—*e-Tributação*—is currently being developed; however, this project has suffered from inordinate delays—it was meant to be completed by 2014—and is not yet fully functioning. In customs, the Single Electronic Window (JUE), which has been operational since 2009, is being further consolidated.

Decentralization implementation has been slow, but some notable progresses have been made. A 2012 decentralization strategy, a comprehensive legal and regulatory framework, and an inter-ministerial working group on decentralization (GIDE) have guided and steered the decentralization process. There have been efforts to better define service delivery responsibilities for the different levels of government; district expenditures have seen the largest increase of responsibilities, starting at only six percent of total government expenditures in 2009 and increasing to 18 percent by 2015. However, the current assignment of service delivery responsibilities still lacks clarity, as, over the years, provinces had gradually assumed an important role in term of territorial development and monitoring of the implementation of sectoral policies. Even if imperfect, a system of intergovernmental fiscal transfers has been put in place to channel resources to finance operation and capital expenditures (CAPEX) at the different levels of subnational government. Municipal taxes are now being collected from a variety of municipal-level sources, and internally generated income constitutes 2.5 percent of provincial revenue and 0.4 percent of district revenue. Provinces and districts now execute their budgets through the e-SISTAFE; municipalities are not connected to e-SISTAFE, but most have acquired off-the-shelf financial applications covering different part of the expenditure chain. Procurement is conducted at local level, although not all municipalities possess a Procurement Unit (UGEA).

Relationship to CPF

The proposed project is consistent with the priorities outlined in the World Bank Group's Country Partnership Framework (CPF) for the Republic of Mozambique (FY2017-21, Report No. 104733-MZ). The project activities will support the achievement of several of the CPF objectives: (i) improving economic management (under Focus Area 1: Promoting Diversified Growth and Enhanced Productivity), (ii) increasing accountability and transparency of government institutions, (iii) promoting inclusive urbanization and decentralization and (iv) increasing accountability and transparency of government institutions. Though the first objective, the CPF seeks to address the challenges brought on by the debt crisis by strengthening economic management. The second involves strengthening public sector management and enhancing transparency, accountability, and citizen engagement. Under the last two objectives, the CPF highlights the importance of local revenue mobilization and the need to strengthen government systems to ensure the transparency and equity of fiscal transfers and allocations.

This project will also contribute towards the World Bank's twin goals. By creating fiscal space through revenue mobilization, improved budget execution, and enhanced transfer of resources to the subnational level, the operation contributes to improved performance and service delivery from the central to local level and thus ultimately to the Bank's twin role of reducing poverty and boosting shared prosperity.

C. Proposed Development Objective(s)

The proposed project development objective (PDO) is to enhance public financial management by strengthening (a) revenue mobilization, (b) expenditure management and control, and (c) fiscal decentralization.

Key Results (From PCN)

Key results include enhanced tax policy and administration, improved management of expenditure and control, and improved intergovernmental fiscal arrangements. The progress towards achievement of the PDO will be monitored and evaluated through the following indicative PDO indicators:

1. Percentage of tax to GDP (%)
2. Public contracts procured through open competition (%)
3. Percentage of central government budget transferred to subnational entities (%)

D. Concept Description

The overall intervention logic of the program is that a combination of interventions (results-based incentives and technical assistance, TA) focused on addressing domestic revenue, PFM and fiscal decentralization bottlenecks will contribute to improved capacities, efficiencies, and performance of central and subnational entities within the key results areas. Ultimately, the project is expected to enhance the ability of government to effectively and efficiently deliver public services.

This package of interventions will be delivered, and associated results achieved, through two complementary windows of support:

- Window 1 will allow for necessary capital and recurrent investments of GoM necessary to achieve the desired results through DLI support with an estimated cost of US$17 million.
- Window 2 will be a conventional IPF, with an estimated cost of $5 million. This TA will be a combination of analytical work, capacity building, training, consultancies to fill critical gaps as they may arise. It includes the hiring of a Maputo-based Senior Public Sector Specialist.

Window 1: Results-Based Financing: *Non-Technical Assistance*

The first window aims to promote the achievement of results in each of the three results areas. This will be done through making available increased funding to incentivize government agencies to improve public sector performance, as monitored through achievement of DLI annual targets. DLIs will be focused on strengthening institutional performance, encouraging intra-institutional coordination, policy implementation and promoting needed reforms to address the bottlenecks in PFM.

A set of specific DLIs within these areas will be formulated and eligible expenditures identified with the Government and MDTF development partners during pre-appraisal. The DLIs selected will involve a mixture of output- and outcome-level indicators. Outputs will involve implementation of PFM systems, adherence to guidelines and policies, and adoption of laws. Outcomes will involve indicators that measure improvements in revenue mobilization and expenditure management. See below for *preliminary examples* of DLIs:

Results Area 1: Improved Tax Policy and Enhanced Tax Administration

- Gradual roll out and increased use of electronic tax systems (including the *e-Tributacao* modules and *Portal do Contribuinte*). Functional targets related to the roll out will be established: (i) clean and complete tax registry (Year 1) (ii) electronic filing (measured by the presence of an electronic filing functionality and its actual use) (Year 2) and (iii) electronic payment functionality (Year 3).

Results Area 2: Improved Management of Expenditure and Control

- Cash Management Committee established;
- Appropriated expenditures processed through the reinstated commitment system;
- Ministries using the upgraded MPA system for the full fiscal year and procurement data disclosed in the online Procurement Portal;
- Mid and end-year financial reports generated from e-SISTAFE including accumulated arrears.

Results Are 3: Improved Fiscal Decentralization

Modalities for the repartition of State transfers to subnational entities for recurrent and investment spending reformed and applied.

Window 2: Strengthening the Institutional Capacity of Government in Revenue and Expenditure Management (TA)

Under this window, capacity-building inputs and TA will be provided to strengthen and supplement existing systems and human resources to enhance their institutional performance and ensure achievement of results from Window 1. Activities under this window will include, but not be limited to: (a) TA, policy reviews, and reform guidance; (b) developing and providing training on manuals, templates, and standards; (c) overall capacity building through training, coaching, orientation, peer learning, and on-the-job training; (d) analytical works to inform ongoing reforms; and, (e) more broadly, support for financial management, human resource management, planning and budgeting, procurement, and monitoring and evaluation (M&E) through trainings and consultancies, as needed.

Component 1 - Strengthen capacity for revenue management aims at 1) improving tax policy analysis and formulation and 2) enhancing the efficiency of tax collection and management. This component will finance technical assistance to AT and MEF-DEEF around:

- medium- and long-term revenue forecasting
- tax impact analysis (ex ante analysis on proposed taxes as well as analysis of the tax burden of the current tax regime on specific groups and sectors)
- harmonization of tax legislation (including laws that result in non-tax fiscal burdens), and development of a DRM strategy
- support to strengthening of core functions of tax administration—registration, filing and payment, arrears management, auditing, and appeals and citizen services,
- rationalizing the institutional structure (mainly provincial offices)
- business process review and greater automation of processes
- greater integration of disparate IT solutions (i.e., *e-Tributação*, e-filing, *Portal dos Contribuintes*, JUE, etc.);
- strengthening national and subnational level capacity, including through professional training, on-the-job training, and change management

Component 2 - Strengthen capacity for expenditure management aims at 1) strengthening the efficiency and transparency in cash management, 2) improving the expenditure chain, 3) enhancing procurement performance and 4) improving the quality, comprehensiveness and use of budget reporting. This component will finance technical assistance to support MEF directorates, UFSA and UGEAs, IGF, and sector ministries on:

- strengthening the institutional structure through the recruitment of a residential advisor to the Treasury
- development of tools for financial programming (circular, templates for collecting cash flow forecasts from UGEs, cash flow planning model and assessment reports on forecasts and actuals)

- improve prioritizing tools/processes for commitment control (setting the commitment ceiling of 50 percent of the annual appropriations for the first quarter, removal of weekly authorization of commitments and upgrade of e-SISTAFE for the issuance of the commitment note)
- improving budget execution control carrying out targeted audits in sectors at risk of exceeding staff ceilings (e.g. the education and health sector)
- providing capacity building to sector ministries on the changes in the budget execution process (procedures, processes, ..), training of e-SISTAFE users to operationalize the control, and conducting change management related activities
- strengthening IT (revision of the MPE business process and deployment and connection to MEX)
- carrying out a review of institutional framework for procurement (clarify roles and competencies among controlling entities -UFSA, IGF, TA, PGR-)
- improving the transparency of official procurement data (online portal),
- providing capacity building to line ministries in procurement planning, execution and contract management
- development of tools/reporting formats to capture expenditure information at UGE level that is recorded outside the e-SISTAFE

Component 3: Strengthen capacity for fiscal decentralization aims at strengthening i) policies, legislation and institutions and ii) enhancing fiscal transfers and budget management at subnational level. This component will finance technical assistance to MEF and subnational entities around:

- improving policies and as needed legal and regulatory framework on fiscal decentralization
- clarify the roles and competencies of the different government levels for better local service delivery
- establish a coherent intergovernmental fiscal transfers system through more transparent, needs-based and predictable transfer to municipalities, provinces and districts as well as reforming the subnational tax system

revise and strengthening procedures for the execution and monitoring of local budgets to increase the effectiveness of public expenditures at the local level.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

Social safeguards - Screening indicates that there are no major irreversible negative social impacts of the project. Some negative manageable impacts are foreseen if the GRM is not functional and if stakeholders are not consulted and informed about project interventions.
Environmental safeguards - Likewise, screening indicates that the expected environmental impacts are negligible, temporary and site-specific. However, The project will include no physical works and anticipated risks and impacts related to staff health and safety are expected to be negligible. The technical advisory-related activities will include expenditure primarily on consultancy services, goods, equipment, training, capacity building, etc., which are likely to have minimal or no adverse environment impacts. The minor environmental risks are indirect and could stem from analytical works as these can unintentionally negatively influence the functioning of Mozambique Public Services and

thus affecting key sectors responsible for managing the environment and living natural resources.

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document**.**

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