PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC25910

Project Name	BELARUS PFM MODERNIZATION PROJECT (P146997)
Region	EUROPE AND CENTRAL ASIA
Country	Belarus
Sector(s)	General public administration sector (100%)
Theme(s)	Public expenditure, financial management and procurement (100%)
Lending Instrument	Investment Project Financing
Project ID	P146997
Borrower(s)	Ministry of Finance
Implementing Agency	Ministry of Finance
Environmental Category	C-Not Required
Date PID Prepared/ Updated	02-Jun-2015
Date PID Approved/ Disclosed	02-Jun-2015
Estimated Date of Appraisal Completion	11-Dec-2015
Estimated Date of Board Approval	28-Mar-2016
Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

1. Belarus is an upper middle income country with a population of 9.5 million. Belarus' transition experience was distinct from others in the region. The country preserves an economic model based on the dominance of public sector with a high level of social equity. The government continues to play a much more active role in Belarus than in neighboring transition economies. Redistribution of resources through the government budget is one important mechanism used to maintain the existing economic model, consequently the overall size of the national budget is large and social spending receives a priority attention.

2. After a decade of strong economic growth, Belarus has faced repeated macro-economic crises in recent years. Loose fiscal and monetary policies in 2010 generated a short-term economic recovery but resulted in a widening current account deficit (15 percent of GDP in 2010) and heightened pressure on foreign exchange reserves. The authorities counteracted the crisis through a combination of tightened macroeconomic policies and a new, more favorable energy deal with

Russia. Together these measures stabilized the economy. Real GDP grew modestly by 1 percent in 2013 and 1.6 percent in 2014, the macroeconomic situation remains fragile. Sharp depreciation of currencies of the country's main trading partners (Russia and Ukraine) put pressure on the Belarusian Ruble, which lost 19.6 percent of its nominal value against the US$ in 2014, despite interventions by the National Bank and adoption of temporary capital controls in December. Meanwhile, external reserves remain precariously low at less than 1.5 months of import coverage. In late 2014, a rapid weakening of the Russian Ruble put pressure on the Belarusian Ruble (BYR), while heightened depreciation expectations triggered additional demand for foreign exchange. Between December 2014 and February 2015, the BYR fell 38 percent against the US dollar.

3. The medium term outlook remains bleak because of low oil prices, a weak external environment, and limited access to external liquidity, and large external public debt refinancing needs of about US$ 4 billion during 2015. The economy is expected to move into recession during 2015, which may continue in 2016, unless the external environment improves substantially. Macroeconomic stabilization is essential but insufficient to reinvigorate growth. Without structural reforms, existing imbalances and vulnerabilities (low growth, persistent current account deficits, reliance on external debt flows, and erosion of competitiveness) are likely to intensify.

4. While economic weakening resulted in lower fiscal revenues, expenditures were curtailed to sustain fiscal discipline. Weak economic activity and declining exports resulted in a contraction of profit and foreign trade tax revenues in 2014 compared to 2013 by 21.3 percent and 33.2 percent, respectively. This was partially offset by increases in excises (2.6 percent), property (7.3 percent), VAT (5.2 percent) and income tax (0.7 percent). Overall, tax revenues dropped by 3 percent y/y. At the same time, capital expenditures were cut by 17.7 percent y/y, helping to decrease real consolidated budget expenditures by 4.8 percent y/y. As a result, the general government budget remained in surplus at 1 percent of GDP in 2014.

Sectoral and Institutional Context

5. Public finances were severely affected by recent macro-economic turmoil but prudent fiscal management contained the fiscal balance throughout the crisis years. Since the 2008/2009 crisis Belarus has experienced a sharp and continuous contraction of revenues. The government avoided a substantial deterioration of the fiscal position through commensurate expenditure consolidation. The overall general government expenditure envelope has contracted by 15 percentage points of GDP – from close to 54 percent of GDP in 2008 to about 39 percent at the end of 2014: one of the largest contractions in the size of government in the region. This was achieved through a significant reduction of capital spending and to a lesser extent through cuts of current transfers, the wage bill and other discretionary current expenditure items. The adjustment also changed the functional composition of the budget, with spending on economic affairs and general public administration experiencing the sharpest reductions while social sectors were largely protected from spending cuts. Despite moderate deficits, public debt (included guaranteed debt) has more than doubled as a share of GDP from 12.9 percent in 2008 to 34.1 percent by the end of 2014. About half of the public debt outstanding matures within the next few years exerting increased fiscal pressures on the budget (external debt repayment needs are about USD 4 billion in 2015 and US$ 1.6-1.7 billion in 2016).

6. The macro-economic outlook for the medium term dictates the need to supplement strict fiscal discipline with stronger emphasis on allocative and operational efficiency of public spending during the coming years. Recent adjustments constrain future fiscal choices. Further cuts in discretionary spending, especially in public investment and non-wage recurrent expenditures

threaten to undermine the productivity of public spending, lead to deterioration of public infrastructure and undermine growth prospects. It is therefore critically important to improve efficiency of public spending and develop instruments for strategic reallocation of resources.

7. The Government realizes that this requires changes in the way it manages public finances. The Ministry of Finance (MoF) is interested in developing a comprehensive PFM reform program and requested World Bank assistance for the design and implementation of such program, including through diagnostic analysis, technical assistance and a PFM lending operation.

8. The Public Expenditure and Financial Accountability (PEFA) Assessment carried out in 2014 has revealed that while Belarus sustained its fiscal discipline over recent years, PFM system in Belarus has several weaknesses which undermine efficiency. The focus on annual budgeting without medium term macro-fiscal outlook and budget envelope limits Government’s ability to strategically plan decomposition of fiscal adjustment and spending agencies’ ability to align their medium term objectives and plans with resources available. This can undermine public service delivery in the longer term. Fragmentation of cash balances in multiple bank accounts outside of treasury hinders prevents the government monitoring its cash position in real time. This, combined with limited capacity to forecast cash flow, and absence of link between procurement and treasury systems, results in cash rationing instead of proactive cash management. Cash flow constraints lead to cuts or the postponement of approved expenditures in year. The structure of controls continues to be heavy and is not conducive to improvements in resource allocation and operational efficiency. The quality and timeliness of financial information is inadequate for high level decisions. Central government, local governments, budget organizations and state owned enterprises account for their transactions differently hindering consolidation of financial information. The debt management function remains fragmented hampering debt portfolio management according to both PEFA and recent Debt Management Assessment (DEMPA)

9. The concept note is based on the Government’s strategic and concept documents for medium term budgeting, program budgeting, treasury, debt management, and accounting. The Ministry of Finance is working on an integrated umbrella strategy for PFM reforms. The draft strategy was prepared by the Ministry and its approval is expected before fall 2015. The ongoing technical assistance project financed from the ECA regional PFM TA grant supports the Government in developing the PFM reform program and preparing for implementation of the PFM operation.

Relationship to CAS

10. The project is aligned with the 2014 to 2017 Country Partnership Strategy (CPS) for Belarus, contributing to the achievement of more transparent management of public resources one of the expected outcomes under CPS pillar 1 aimed at improving competitiveness of the Belarus economy.

11. The proposed PFM Modernization Project is aligned with the World Bank Group's twin goals of shared prosperity and reduced poverty by supporting government reforms that enable the Government of Belarus to become a more effective and efficient institution and by improving allocative efficiency of the PFM system. The proposed institutional reforms will strengthen the overall governance environment by improving transparency and accountability in the PFM. Project will facilitate better value for money in service delivery and pro-poor government programs.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

12. This operation will support Government's PFM reforms, Financial Management Information System (FMIS) design and FMIS implementation as a series of investment projects financed by two IBRD credits. The project development objective (PDO) for the series is to improve efficiency and transparency of the national public finance management system of Belarus.

13. PDO for the first operation in this series is to develop a) the regulatory framework for budget preparation, execution, accounting and reporting and b) the specifications and implementation arrangements for a new Financial Management Information System that will support implementation of the regulatory framework. The Second operation will focus on establishment of the new FMIS.

Key Results (From PCN)

14. The project is expected to achieve PDO by improving the ability to better plan the budget in medium term perspective, supporting establishment of internal control environment that facilitates focus on results, and improving reliability of financial data, which is essential for managing fiscal risks and decision-making. The achievement of PDO will be assessed on the basis of the following results indicators, indicators (b) and (d) will be used as triggers for moving to the second project – FMIS implementation:

(a) Medium Term Budget Framework (MTBF) is legislated and implementation guidelines developed and approved.

(b) Revised chart of accounts integrated with the budget classification is approved.

(c) Treasury Single Account (TSA) coverage is expanded by incorporating extra-budgetary funds and own source funds of budget organizations.

(d) Detailed functional and technical requirements for Financial Management Information System (FMIS) are developed based on approved new business processes.

III. Preliminary Description

Concept Description

15. The series of projects will be financed by two loans. Estimated amount of the 1st loan – USD 10 million. The estimated amount of the overall series is USD 100 million. Initiation of the second project will be conditional on achieving two triggers (PDO indicators b and d in bold) identified above and does not need to coincide with the closure of the first project. The first project will include 3 components briefly described below.

Component 1 – Budget management regulations and procedures

16. Budget preparation. The component will enhance ability of the Government to plan for medium term period and in a more strategic way by supporting implementation of the Government’s “Concept of Transition to Medium Term Budgeting based on Results”. This component will finance technical assistance on: macroeconomic and macro-fiscal forecasting; revision of the guidelines for budget preparation; the methodology for design of performance indicators, monitoring of program implementation and evaluation of programs.

17. Budget execution. The component will enhance the ability of the Ministry of Finance to manage its cash position, future spending, and identify potential problems early on by expansion of treasury coverage, consolidate funds and increase control over cash management. This component will provide technical assistance for: expansion of TSA coverage to include extra budgetary operations (EBOs), defining responsibilities and segregation of duties over EBOs of budgetary organizations such as schools, hospitals and other service delivery units; streamlining budget execution controls (including strengthening of commitment controls, establishing link between procurement and treasury systems, and improving recording of arrears); and development of cash management tools and procedures.
18. Strengthening of debt management. The component will support implementation of the recently approved Debt Management Strategy for 2015-2020. The activities will focus on technical assistance for: integration of reporting and management of domestic, external debt and contingent liabilities; debt portfolio management; and development of a domestic securities market.
19. Accounting and financial reporting. This component will finance technical assistance to support the initial stage of implementation of public sector accounting reform. Activities will include: definition of institutional responsibilities and setting up a work plan for development of accounting standards according to international standards; gradual implementation of internationally accepted accounting standards in line with selected IPSAS based on a Road Map, accounting legislation and key fiscal priorities; and redesign of the national chart of accounts and its integration with the budget classification, developing requirements to the content of financial reports.
20. Internal financial control. This component will provide technical assistance to support development of the “Concept for Modernization of Internal Financial Control” as well as gradual introduction of the internal audit function elements into the public sector operations based on investigation of international experience and tailoring it to the national context in Belarus.

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Component 2 PFM IT solutions design and implementation
21. Business Processes. This component will provide technical assistance to: develop new or revise existing business processes based on the reform initiatives in the areas of budget planning, execution, debt management, procurement, accounting and reporting; and prepare tender documentation, including technical specifications based on the revised business processes.
22. FMIS Specifications. The component will prepare for the procurement of a Financial Management Information System by financing: market analysis of existing off the shelf solutions, competitive analysis of available hardware; and the preparation of draft technical specifications to obtain feedback from the market and ensure speedy procurement process under the second project.
23. Debt Management System. The component will finance the acquisition of a Debt Management Information System by financing: the development of technical specifications; design of the information system; and procurement of debt management solution.

Component 3 - Change management
24. The change management component will support the implementation of regulatory and procedural reforms through a program of capacity building an d communication activities.
25. Project Implementation Office. Funds under this component will be used to support the functioning of the project implementation office, which will: carry out project procurement, financial management, and audit activities; help the Ministry of Finance coordinate project activities and interact with all local and international entities involved in the project.
26. Capacity Building. The component will support capacity building activities, including training and awareness raising to support the implementation of the medium term budgeting,

accounting and internal control reforms), development of training programs for the MOF training center and profile universities, publication of training materials, and training of trainers.

27. Communication Activities. Component resources will also be used to support communication activities, including workshops, conferences, study visits, and communication through different media to reach internal and external audiences.

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	Yes	No	TBD
Environmental Assessment OP/BP 4.01		✕	
Natural Habitats OP/BP 4.04		✕	
Forests OP/BP 4.36		✕	
Pest Management OP 4.09		✕	
Physical Cultural Resources OP/BP 4.11		✕	
Indigenous Peoples OP/BP 4.10		✕	
Involuntary Resettlement OP/BP 4.12		✕	
Safety of Dams OP/BP 4.37		✕	
Projects on International Waterways OP/BP 7.50		✕	
Projects in Disputed Areas OP/BP 7.60		✕	

V. Financing (in USD Million)

Total Project Cost:	10.00	Total Bank Financing:	10.00
Financing Gap:	0.00		

Financing Source	Amount
Borrower	0.00
International Bank for Reconstruction and Development	10.00
Total	10.00

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