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**INTERNATIONAL MONETARY FUND**  
**FISCAL AFFAIRS DEPARTMENT (FAD)**

**Project Proposal for External Financing of TA Activities**  
**Developing Fiscal Risks Management in Mozambique (2016-2018) -**  
**FAD\_MOZ\_2016\_02**

Country	<b>Mozambique, Republic Of</b>	FY	<b>2017</b>	Lead Dept.	<b>FAD</b>	Area Dept.	<b>AFR</b>
Project Data	<b>FAD_MOZ_2016_02</b>			Planned Dates	<b>December 1, 2016 – January 30, 2019</b>		
Project Title	<b>Developing Macroeconomic Capacities and Fiscal Risks Management in Mozambique (2016-2019)</b>						
Project Manager	<b>Xavier Rame</b>			Name of Expert(s)			
Donor Ref#	<b>Belgium</b>			HQ/RTAC	<b>FADM2 / AFS</b>		
IMF Program	<b>Yes</b>			Budget	<b>EUR 1,000,000</b>		
If extension, please indicate previous Ref#				Std Cost Grp			

**I. PROPOSAL AIM AND OBJECTIVES**

The proposed project, covering the period December 1, 2016 – January 30, 2019, will help the authorities strengthening their capacity to identify and manage the key fiscal risks they face and reinforce their medium-term fiscal framework.

**II. BACKGROUND**

From the mid-1990s to 2015, Mozambique had preserved macroeconomic stability and debt sustainability while promoting economic development. The macroeconomic situation has deteriorated since 2015 but Mozambique's economic prospects remain positive given planned massive investment in natural resources. While GDP growth averaged 7 percent in recent years, Mozambique's per-capita income (\$624 in 2014) and human development index (178 out of 187 countries) remain low. There is a need to continue implementing policies that support fiscal sustainability, infrastructure investment, and inclusive growth. Over the medium term, efforts to develop a sound framework to manage natural resource wealth should be stepped up.

Mozambique's achievements have benefitted from sustained support from development partners and several economic and financial programs supported by the IMF. On the fiscal component of the structural reforms agenda, the IMF's Fiscal Affairs Department (FAD) has provided extensive technical assistance (TA) in public financial management (PFM) over the past 15+ years. This assistance has been a key supporting element for building relevant fiscal institutions in a post-conflict country. The authorities have made good use of this TA and many of the recommendations have been implemented through donor-funded projects based on a phased strategy. Over the medium-term, TA should continue to support the country's development agenda, with a focus on: (i) improving PFM, tax policy and administration, and natural resource wealth management; (ii) addressing infrastructure gaps in a fiscally sustainable way while ensuring the quality of public investment, and strengthening debt management; (iii) strengthening fiscal transparency and the oversight of fiscal risks; and (iv) strengthening management of risks to the tax system to improve tax compliance.

The discovery in April of \$1.4 billion (10.4 percent of Mozambique's GDP) of previously undisclosed loans has pushed the total stock of debt at end-2015 to 86 percent of GDP. According to the IMF's technical assessment, public debt is likely to have reached a high risk of distress. This situation highlights the need to further strengthen macrofiscal and fiscal risk management.

### **III. PROJECT DESCRIPTION**

#### **Project Scope**

New challenges for PFM reforms are on the horizon. With the prospect of Mozambique becoming a major resource economy, the requirements for investment planning, debt and cash management, fiscal transparency, and risk management will increase. The processes and institutional capacities to meet these challenges need to be developed in the coming years. Strengthening the management of fiscal risks and the technical capacities to undertake macrofiscal analysis and forecasting to support policy-making should now be key priorities.

However, limited capacity and institutional weaknesses in the fiscal framework still prevail in a number of areas. This could jeopardize macroeconomic stability and fiscal sustainability if not addressed before the expected surge of natural resource revenue. In 2016, the creation of a strategic unit in charge of macrofiscal and fiscal risks management issues, reporting directly to the Minister of Economy and Finance, is a first step to build the required capacities.

#### **Expected Results**

This project should help technical staff get acquainted with relevant methodologies, adapted to the Mozambican context in light of existing capacity and data constraints. At the same time, the project will also seek to sensitize higher-level policy makers regarding the need to (i) introduce appropriate institutional changes to improve fiscal analysis and management and (ii) link macrofiscal analysis to policy-making through seminars and workshops.

Section IV presents the expected outcomes and the related milestones of the project.

#### **Delivery Modalities**

Given the technical nature of the issues and the importance of building local capacity, the main modality of TA delivery will be a resident-advisor, based in Maputo. In addition to the daily support to the authorities on macrofiscal and fiscal risks issues, the project's objectives will be pursued through a number of inter-related activities, including technical workshops and seminars. As human resources development and capacity building are key to ensuring sustainability of the TA provided, the resident advisor terms of reference will put a special emphasis on the development of capacities. She/He will design a training and capacity development program.

The project will use a combination of analytical work and toolkits, including the "*Macroeconomic Policy Frameworks for Resource Rich Countries*", the Fiscal Transparency Code's principles on "*Fiscal Risk Analysis and Management*" and "*Analyzing and Managing Fiscal Risks: Best Practices*" developed by FAD staff.

The main tasks of the resident advisor will be:

1. Identify functional capacity constraints across the Ministry of Economy and Finance to undertake core macrofiscal functions, including the analysis and mitigation of fiscal risks, and provide an action plan to address these constraints;
2. Provide methodological and operational support to the Ministry's staff to undertake macro-fiscal analysis and forecasts, including the identification and analysis of fiscal risks.;
3. Help staff in gathering and analyzing the required data and information to develop the medium-term fiscal framework and to prepare the annual fiscal risk statement (FRS).;
4. Provide training to ensure that the authorities are able to (i) independently update the FRS every year; and (ii) gradually improve its analytical content and extend its coverage.

An installation mission will draft detailed terms-of-reference for the resident advisor, set-up in agreement with the authorities and the Belgium embassy. They will be updated, if needed, after each inspection visit to ensure the alignment of the project with the authorities' priorities and their IMF-supported program

### **Complementary TA from Other Providers**

The project will leverage other TA provided by FAD, AFRITAC South (AFS), the World Bank, and other donors in related areas to avoid duplication and strengthen institutional capacity for fiscal policy formulation, including debt and cash flow management, public investment, and fiscal reporting.

Several donors are supporting the implementation of Mozambique's reforms on public finances in a coordinated way. To ensure a sound coordination of the project with all the development partners' initiatives, the resident advisor will work closely with the TA coordinator based at the IMF Resident Representative office.

Regarding public financial management, since 2002, a Partnership Committee of donors has pooled their resources in a Common Fund to support the SISTAFE reform according to a Memorandum of Understanding agreed with the government. The Partnership Committee includes Sweden, Norway, Denmark, United Kingdom, Belgium, Italy, and the EU. The World Bank and the IMF are observers.

In addition, various development partners provide technical assistance and support to the reforms on a bilateral basis.

In cooperation with the Danish government, the Fund support the formulation of PFM modernization strategy with a specific focus on: (i) reviewing the relevance of the upcoming revised PFM vision and the related action plan; (ii) assessing progress with the completion of the SISTAFE reforms, which in the future will cover the whole spectrum of PFM reforms; and (iii) monitoring the implementation of the five-year fiscal transparency action plan based on the FTE findings. In addition, the IMF provides strategic advice to address the challenges of natural resource management through the Managing Natural Resource Wealth Topical Trust Fund. In addition,

AFRITAC South's provides complementary TA, with a specific focus on cash management and fiscal reporting.

## LOGICAL FRAMEWORK

Project Objective 1	
1. Comprehensive, Credible, and Policy Based Budget Preparation	
Outcome 1.1	Verifiable Indicators
A more credible medium-term macro-fiscal framework is included in budget documentation	<p>PEFA PI-14: Macroeconomic and fiscal forecasting <i>Baseline: to be defined during the inception mission of the project to take into account the latest budget documentation available (FY17).</i></p> <p>PEFA PI-15(2): Fiscal strategy (Fiscal strategy adoption) <i>Baseline: PEFA Assessment Report 2015: (i) The tree core elements of fiscal strategy are not available; (ii) Macroeconomic assumptions are not explained and the medium-term fiscal scenario (CFMP) does not include risk to debt analysis.</i></p> <p>PEFA PI-16. Medium-term perspective in expenditure budgeting <i>Baseline: to be defined during the inception mission of the project to take into account the latest budget documentation available (FY17).</i></p>
Milestones	Date
The macrofiscal forecasts prepared by the government include a qualitative assessment of the impact of alternative macroeconomic assumptions.	June 2017
The government prepares forecasts of key macroeconomic indicators, which, together with the underlying assumptions, are included in budget documentation submitted to the legislature. These forecasts cover the budget year and the two following fiscal years.	September 2017
The government prepares forecasts of the main fiscal indicators, including revenues (by type), aggregate expenditure, and the budget balance, for the budget year and two following fiscal years. These forecasts, together with the underlying assumptions, are included in budget documentation submitted to the legislature.	September 2017
The government prepares, for internal use, a range of fiscal forecast scenarios based on alternative macroeconomic assumptions. The budget documents include discussion of forecast sensitivities.	June 2018
The annual budget presents estimates of expenditure for the budget year and the two following fiscal years allocated by administrative and economic classification	September 2018

Project Objective 2		
2. Strengthened Identification, Monitoring and Management of Fiscal Risks		
Outcome 2	Verifiable Indicators	
Disclosure and management of contingent liabilities and other specific fiscal risks is more comprehensive	PEFA PI-1: PI-10. Fiscal risk reporting Baseline: <i>PEFA Assessment Report 2015: (i) No consolidated report on the financial performance of the public corporation sector is published by central government annually; (ii) Subnational governments report on their revenues, expenditure, and balances annually and are not allowed to borrow; and (iii) contingent liabilities are not generally reported in the CGE.</i>	
Milestones		Date
The FRS becomes a chapter of the government's main forecast documents (the Cenário Fiscal de Médio Prazo and/or the Proposta de Orçamento do Estado), not a standalone document.		September 2017
The analyses of the differences between past forecasts and actual outcomes are further developed and their implication on the uncertainty of current forecasts discussed.		September 2018
The FRS includes a developed analysis of the risks created by public corporations (whatever their legal form) by showing each corporation's guaranteed and unguaranteed debt, assets, leverage, profit, etc.		September 2018
The FRS includes a detailed section on the uncertainties surrounding future revenue from the production of natural gas.		September 2018
The FRS is published by central government annually, as a chapter of the government's main forecast documents. It quantifies and consolidates information on all significant contingent liabilities and other fiscal risks of central government.		November 2018

#### IV. RISK ASSESSMENT AND MITIGATION

Risk Description	Mitigation Measures	Importance of Risk
<b>Political Support</b>		
The creation of the Ministry of Economy and Finance is a major breakthrough and demonstrate the authorities' willingness to improve the macrofiscal projection and fiscal risks management capacities. In addition, the authorities expressed their willingness to develop the organization and tools required to handle the challenges arising by the expected surge in revenue from natural wealth.	The installation and inspection missions will meet with the senior management of the ministry to ensure that the project is fully aligned with the government priorities. Seminars will ensure the dissemination of the project outcomes to ensure a broad political support.	Low
<b>Management Support and Commitment</b>		
The authorities have repeatedly indicated that they want to go ahead with the reforms in this area but budgetary constraints and other priorities have imposed some difficulties to implement the agenda of reforms. The minister requested this project.	The installation and inspection missions will meet with the senior management of the ministry to ensure that the project is fully aligned with the government priorities.	Low
<b>Capacity to achieve results</b>		
The weak analytical capacity is now spread across a number of units and departments.	Establishing the macrofiscal and fiscal risk unit would draw the scarce talents and expertise currently dealing with a number of functions—from project appraisal and financing, to micro analysis and macro-fiscal projection—under one unit. The project will focus on building the capacities within this unit through hands-on transfer of experience and expertise.	High
<b>Timeliness</b>		
The outputs of the project could be disconnected from the budgetary calendar, undermining its legitimacy and efficiency.	Key milestones of the project have been designed to support the budget preparation process. They will be reviewed during the installation and the inspection missions to ensure their realism.	High
<b>Sustainability</b>		
While the creation of the macrofiscal and fiscal risk unit would facilitate the development of durable capacities, the government will face the challenges related to the retention of its staff, especially in a context of an increasing competition with the private sector to attract and retain the talents.	The organization and the staffing of the unit will be discussed during the installation and the inspection missions.	Medium

## V. BUDGET

The implementation of the project requires **the following activities for the period December 2016 - January 2019:**

- **Resident Advisor:** one advisor based in Maputo from December 2016 - January 2019.
  - Provide daily support to the authorities on macrofiscal and fiscal risks issues, in close cooperation with the TA coordinator. He/She will ensure the complementarity of this project with the TA provided by the various development partners involved in fiscal matters.
- **Installation mission:** one mission (1 staff, 1 expert, 1 week) in December 2016
  - Introduce the resident advisor to the authorities and the development partners.
  - Validate the detailed terms-of-reference of the resident advisor, in agreement with the authorities and the Belgium embassy.
- **Inspection missions:** two missions (1 staff, 4 days) in June 2017 and June 2018
  - Review the project's achievements.
  - Update the resident advisor's terms of reference, if needed, to ensure the permanent alignment of the project with the authorities' priorities.
- **Backstopping visits of the resident advisor to IMF Headquarters:** two visits (5 days) in 2017 and 2018:
  - Review the project's achievements.
  - Participate in training designed to enhance the effectiveness of the resident advisor and develop his technical expertise in the fields covered by the project
- **End-of-project mission:** one mission (1 staff, 7 days) in January 2019
  - Review the overall achievements of the project.
  - Assist the authorities with the formulation of capacity building in the macrofiscal and fiscal risks management area for the next 2-year period.
- **Workshops and seminars:** 2 workshops/seminars to (1) sensitize higher-level policy makers regarding the need to introduce appropriate institutional changes to improve fiscal analysis and management and (2) disseminate at the technical and operational level the main outputs of the project. They will be organized by the resident advisor.
  - Provide a forum to discuss key fiscal issues,
  - Ensure an effective and sustainable transfer of knowledge,
  - Share international experiences,
  - Disseminate analytical work related to the objectives of the project to the key stakeholders of the project.

In addition, the resident advisor will be backstopped by the Fiscal Affairs Department staff who will (i) guide her/his work and (ii) provide technical and analytical support to his/her initiatives in the field.

### PROJECT BUDGET

Budget ID	Description	Amount
1101	Long-term Expert	US \$696,000
1101B	Long-term Expert BKSTP	US \$153,000
1151	ST Expert TA mission	US \$22,000
1601	Staff TA mission	US \$74,000
5111	HQ TA mission	US \$41,000
3301	Workshop/Seminar	US \$20,000
5341	Project Management	US \$25,000
4101	Misc./Office Expenses	US \$12,000
<b>Sub-Total</b>		<b>US \$1,043,000</b>
<i>Trust fund management fee</i>		<i>US \$73,010</i>
<b>Total Budget</b>		<b>US \$1,116,010</b>