

ANNEX

1. IDENTIFICATION

Title/Number	LIBERIA - Budget Support for Macroeconomic Stabilisation (BSMS) CRIS 2009/021-455		
Total cost	EUR 20,200,000		
Aid method / Management mode	General budget support – centralised management Complementary support – joint management with the International Monetary Fund (IMF)		
DAC-code	51010	Sector	General Budget Support

2. RATIONALE AND COUNTRY CONTEXT

Liberia is a poor post conflict fragile state with unsustainable debt struggling to recover and develop its economy. The proposed budget support operation is formulated taking this difficult context into account. Budget support is a positive signal from the EC for supporting the efforts undertaken by the Government of Liberia (GoL)¹. The project will also contribute to alleviate the foreseen negative impact of the world economic crisis on the revenue outlook for FY 2009/10. The programme is consistent and fully in line with the general EC policy framework on development cooperation and with the EC communication towards an EU response to situations of fragility², as well as with the Budget support for fragile states guidelines.

The main objective of the general budget support (GBS) in Liberia is to maintain and improve a stable macroeconomic framework, to reinforce the national Public Finance Management (PFM) capacity and to ensure that the population has access to health and education services. Besides, it should contribute, together with budget support from other institutions, to reduce poverty in the country through the implementation of the Poverty Reduction Strategy (PRS) adopted in 2008. The main results are the strengthening of the macroeconomic framework and the reinforcement of the public finances, notably with the support of an IMF technical assistance, and better service delivery in the sectors of Health and Education.

2.1. Country Context and National Policy and Strategy

2.1.1. Economic and social situation and poverty analysis

Although real GDP growth for the year 2008 as a whole is estimated to be at the programmed level of 7.1 %, activity weakened in the 2008 fourth quarter with a decline in rubber production - Liberia's main export product. Diamond exports began to decline from end-year. There is also some evidence of lower remittances since the beginning of 2009. Some downside risks identified by the IMF and the authorities in 2008 have materialized: the projected acceleration of output growth in the period 2009 - 2011 based on an expansion of mining and timber production is likely to be pushed back by about two years, due to weak market demand, low international prices and deferred foreign direct investment. The outlook

¹ By adopting a national poverty reduction strategy, being eligible and applying the IMF PRGF, and by setting up a national framework on PFM reforms.

² COM (2007) 643 of 25/10/2007.

for rubber and diamond production is also weak. Accordingly, GDP growth is likely to slow to around 5% in 2009 (initially projected before the crisis to rise at about 13% in 2009), consistent with exports declining substantially and domestic demand largely holding up, with gradual recovering during 2010-2012. Risks to the growth forecast due to a sharper-than-projected slowdown in global growth or a decline in world commodity prices will reduce demand for Liberia's key exports, and may delay investment activity in these sectors, more than projected. A slowdown in remittances or donor inflows could also negatively impact on economic prospects. The recent PRGF review stressed the importance of maintaining aid flows.

Despite substantial recovery efforts since the end of the civil conflict, the country remains one of the poorest in the world, with a per capita GDP of only USD190 in 2007³. According to the 2007 Core Welfare Indicator Questionnaire (CWIQ) results, poverty incidence is high, with 68% of the rural population and 55% of the urban population living on less than 1 USD per day, with children and the elderly the largest groups living in poverty.

2.1.2. National Development/ Cooperation Policy and Strategy

(1) National policy and strategy:

Liberia completed its first full PRSP in March 2008 that sets out the government's priority agenda for the three year period April 2008 to June 2011. The four pillars of the PRSP are (i) Security, (ii) Economic revitalization, (iii) Governance & Rule of law, (iv) Infrastructure & basic services. The cost of its implementation has been estimated at around \$ 1.5 billion with initial donor contributions estimated at \$300 to 400 million (without UNMIL, which is an economy of its own in the country, while nevertheless contributing to some deliverables through infrastructure works in particular).

(2) National Budget and medium term financial perspectives:

The Liberian Legislature agreed in August 2008 on a National Budget of US \$ 298 million for the FY 2008/09. In the execution of the FY 2007/08 cash-based budget, GoL made substantial gains in revenue collection as revenues rose by close to 40% compared to FY 2006/07. This was almost 10 % higher than the budget target. The strong performance reflects the continued strong economy, iron ore concession payments, and gains from the reorganization of domestic tax administration, during the period. The Budget 2008/09 was underpinned by the Poverty Reduction Strategy Paper (PRSP). Its objectives of consolidating peace, revitalizing agriculture, rebuilding the economy and social infrastructure, promoting good governance, the rule of law and strengthening the environment for private sector growth have been identified as the policy priorities and have been reflected in financial terms to the 2008/2009 national budget. The fiscal policy reforms to be pursued aimed at enhancing revenue collection by introducing tax policies that support economic growth and expanding the tax base. However, due to an unexpected loss of fiscal revenue from the world economic crisis, the Sirleaf Government had to report in May 2009 for the first time a , implicating an \$11 million cut in expenditure targeted on fuel purchases and General services.

Slower GDP growth and lower import prices weaken the revenue outlook for FY2009/10. The draft fiscal year 2009/10 budget amounts \$347 million, a nevertheless 16% increase over the 2008/09 fiscal year. According to top appropriations by spending entities, 11.5% of the draft budget goes to the Ministry of Public Works, 11% to the Education sector, 8% to the Health sector and 9% to the Justice sector, including the Police, which is again in line with PRSP. This draft budget is funded through tax revenue (58%), especially taxes on international trade, and from non-tax revenue (42%), including payments from concession

³ International Monetary Fund, Macroeconomic Framework, 2007.

agreements for counties and communities, as well as grants from the World Bank, ADB and the present EC budget support. Some revenue risks remain notably import duties, forestry and telecommunications license fees.

(3) *Performance Measurement:*

The PRS implementation is monitored by the Reconstruction and Development Committee (LRDC), chaired by the President and meeting on a monthly basis, where Ministers report on the implementation of the deliverables/pillars, in the presence of representatives of the international community. The Ministry of Planning has developed a PRS deliverables tracking system computer programme, which also captures externally financed projects, down to the county level. The PRS monitoring system is being established with the support of the UNDP, including at county level where a manager will soon be deployed in each of the 15 counties.⁴ Macroeconomic outturn is monitored closely via the regular ongoing IMF PRGF reviews to ensure that the level of macroeconomic risk arising from the financial crisis remains manageable particularly as regards the financing of the budget. The IMF has placed TA to develop the PFM strategy in the Finance Ministry and the FAD are expected to regularly visit the country to monitor the PFM plan. The complementary TA support foreseen by the present programme will enhance the monitoring of the PFM reforms.

2.2. Eligibility for budget support

2.2.1. National Development or Cooperation Policy and Strategy

The Liberian PRSP is published and validated by the IMF/WB and the budget 2009-2010 has been designed according to the PRS pillars. Budget allocations to the health and education sectors are approximately 7-8% respectively. Consequently, the first EC GBS eligibility criterion is met. However, PRS implementation performance during the first year has been low, mainly because of weak institutional and financial capacity, achieving only 8% of the 3 year programme total.

2.2.2. Macroeconomic situation

In the past years, Liberia's macroeconomic framework was supported by the IMF through a Staff-monitored program (SMP). Liberia has now an ongoing PRGF facility and has successfully completed in May 2009 its second review. In addition, the country is receiving interim relief under the HIPC Initiative and is scheduled to reach Completion Point in mid-2010.

The economy has potential for growth in the medium to long term, although there are important risks arising from the world crisis (weakening export receipts owing to falling commodity prices and weak external demand; delays or scaling down of FDI and the related production and exports, downturn in remittances). Growth is driven by a recovery of capacity utilization and associated improvements in factor productivity, notably in key sectors (mining and rubber). According to the recent IMF Art IV report (January 2009), and despite the economic crisis, real GDP growth is projected to accelerate sharply over the medium term, rising from 7.5% in 2010 and to 10.3% in 2011 and 13% in 2012.

From the point of view of the IMF and the WB, Liberia macroeconomic policy is ensuring sufficient stability to provide sustainable economic growth for the years to come. Thus this eligibility criterion is judged to be met.

⁴ Part of the 70 American – Liberian recruited by the UNDP over a period of 3 years.

2.2.3. Public Financial Management

Over the past three years, Liberia has strengthened public expenditure management and financial transparency, and made considerable efforts in the area of revenue mobilisation leading to a significant increase in government revenues (+40% from FY 2006/07 to FY 2007/08). The WB-led PEMFAR/PEFA exercise carried out in late 2007 suggests that the overall PFM system is weak but with some area where improvement in performance is already observable at aggregate level. Procurement is an area of particular weakness identified in the PEMFAR/PEFA exercise and has major implications for the State Owned Enterprise (SOE) sector (which amounts to around 25% of GDP and half the public sector). The procurement Law is in the process of being amended and the accompanying regulations and manuals are also under preparation. A particular issue in this respect is the coverage of the SOEs in the PFM strategy, where SOE as a substantial source of off-budget revenue are in many cases still not well regulated. At present, the PFM action plan exists and the PFM reform strategy is about to be formalised with the adoption of the Public Finance Management Law currently under discussion by Parliament. The implementing regulations of the law still need to be formulated. The IMF Fiscal Affairs Department (FAD) follow-up mission at the end of June was an important step for the further development and implementation of PFM strategy. The GOL reform matrix on PFM (encompassing the existing strategy) is based on the IMF analysis and many of the requirements are already under implementation. The essentials are in place for the implementation of the formal PFM strategy and this work will be undertaken between now and the end of 2009.

The adoption of PFM and Public Procurement (PP) implementing regulations will now be an important step in this regard, and would allow for further improvements in budget preparation and implementation and a more efficient allocation of government resources to achieve Liberia's poverty reduction goals. Taking into account the confirmed positive trend in PFM reforms since 2006, and the solid TA from GEMAP and IMF, the PFM criteria of eligibility can be assessed positively in the framework of a country in situation of fragility, provided that the two regulations (PFM and PP) are adopted.

2.3. Sector Policies

This budget support policy is linked to other ongoing and planned projects in the sector of Education, Health and PFM (through the reinforcement of the capacity of the General Auditing Commission).

2.4. Lessons learnt

This is the first budget support operation held in Liberia. Liberia having demonstrated its efforts in reaching HIPC Decision Point⁵, and following the multilateral agreement between donors and Government of Liberia at the Partners' Forum in Washington DC, the EC has implemented in 2007 and in 2008 two macro-economic stabilisation programmes consisting in partial payment of (i) the 9th FED EIB arrears (EUR 3,500,000) and (ii) Liberian arrears to AfDB (EUR 8,000,000).

2.5. Complementary actions

In parallel to the ongoing PRGF, the AfDB approved an \$18 million GBS programme, of which \$12 million were disbursed at the beginning of 2009. The WB approach is around \$5

⁵ Debt relief strategy-HIPC decision point qualification

Five criteria had been used to assess Liberia's decision point qualification and its eligibility for HIPC assistance, namely, (i) satisfactory macroeconomic management and progress since January 2006; (ii) widespread poverty across the country and weak service delivery; (iii) preparation of an Interim Poverty Reduction Strategy Paper (I-PRSP); (iv) unsustainable debt stock; and (v) promotion of good governance and the rule of law.

million a year, through annual Re-engagement and Reform Support Programmes (RRSP). PFM reform is supported by the Governance and Economic Management Assistance Program (GEMAP), the World Bank (notably through the US\$11million Governance and Institutional Reform Project), and the IMF.

EC support to the General Auditing Commission in the form of Long Term Technical Assistance and direct funding of the General Auditor position is provided under the EDF 9 Institutional Support and Capacity Building Programme until July 2009. The GAC contributes significantly to increased transparency and accountability of public finance management. Its positive performance has been one important element of the EC's favourable assessment of PFM reform progress. Maintaining and further enhancing GAC capacities to conduct independent professional audits is a crucial element of PFM reform. Therefore the EC offered to continue funding both GAC support components until April 2011, the end of the current GA tenure.

2.6. Donor coordination

The main forum for donor coordination is the LRDC and the meetings held for each of the 4 LPRS pillars at technical level. The Ministry of Finance calls Budget Support Working Group meetings, which the donors involved in PFM attend, including some not contemplating BS as an implementation modality (UNDP, USAID). The IMF plays a predominant role in the country, both to ensure that the macro-situation remains stable despite high pressures on the budget in a difficult international environment, but also, as usually in fragile situations, on the PFM front.

3. DESCRIPTION

3.1. Objectives

The main objective of the general budget support (GBS) in Liberia is to maintain and improve a stable macroeconomic framework, to reinforce the national Public Finance Management (PFM) capacity and to contribute to a better access of the population to health and education services.

3.2. Expected results and main activities

In the short term, GBS is supposed to ease budget execution, avoid arrears accumulation and strengthen structural PFM reforms. Liberia's macroeconomic framework is expected to be further strengthened (decreasing fiscal deficit, improved current account balance) and budget credibility improved. GBS will contribute to support the implementation of the Poverty Reduction Strategy notably in health and education sectors. As regards support to PFM reforms, the EC contribution to IMF Technical assistance will allow a more transparent, efficient and effective management of public resources and will reinforce budget support's objectives and results.

3.3. Stakeholders

The main stakeholders of GBS/PFM will be the GoL and primarily the MoF. Performance indicators will address budget execution by ministries of Health and Education, in accordance with the GoL's policy agenda. Other DPs (and IMF) are also stakeholders.

3.4. Risks and assumptions

Political stability is a key assumption as opening a political dialogue under Cotonou Art. 96 would freeze disbursements. The government's commitment, at the highest level, to the implementation of the PRS can not be questioned. The PRS implementation may however suffer from a weak institutional and financial capacity, to be reinforced with the support of the international community. Maintaining a stable overall macroeconomic framework fully in line with IMF programme (PRGF

“on-track”) is a key assumption for the implementation of the programme. The major risk related to the macroeconomic framework is the impact of the financial crisis which will certainly lower the growth rate, reduce FDI and remittances and possibly diminish the level of aid flows. External and domestic arrears also remain a concern that should be mitigated with the expected completion point to be reached early 2010, and the eligibility to MDRI thereafter. Endemic corruption and funds embezzlement will constitute a significant risk of this operation. In this context, continuing the PFM reforms and institutional support during the covered period is indispensable. Risks are being mitigated with (i) the adoption of the forthcoming PFM legislative framework and the adoption of its implementing regulations (which is a pre condition to the present programme), and (ii) a reinforced harmonised donor support on this priority sector, notably through GEMAP, the creation of a PFM oversight Committee, supported by an EC financed long term IMF technical assistance for the monitoring and implementation of the PFM action plan, a second harmonised PEFA exercise, the establishment of a Common Donor Performance Assessment Framework, the EC support to the GAC, and the fiscal and governance reforms included in the PRGF. Finally, the political will of the current administration is clearly demonstrated and needs to be confirmed until the final year of the programme, which coincides with the next electoral year.

3.5. Crosscutting issues

The EC budget support should generate positive results at political, economic and social levels. In particular, the project should improve good governance practices by fostering transparency and accountability in the use of public funds. It will also contribute to improved budget positions of the Health and Education sectors.

4. IMPLEMENTATION ISSUES

4.1. Budget and calendar

Decision was made at the Country Team Management in May 2009 to set the overall budget of the BS amounts at EUR 20,200,000. An amendment of the CSP/IP is required for that purpose. The present Action Fiche covers a direct and untargeted operation (2009-2011). It will be organised on an annual basis with two fixed (FT) and one variable tranche (VT). The first disbursement (fixed tranche) should take place in mid-2010. Apart from the budget support tranches, the programme will have an institutional strengthening and capacity development component of EUR 1,100,000 mainly implemented through a contribution agreement with the IMF (EUR 1,000,000). This TA envelope will support implementation of the PFM reforms, as well as the coordination of the contributions from other donors. A provision of EUR 100,000 is foreseen to cover evaluations and audits.

Nature	Amount (EUR)
Fixed tranche Fiscal year 2009-2010	7,000,000
Fixed tranche Fiscal year 2010-2011	7,000,000
Variable tranche 2010-2011	5,000,000
Technical assistance	1,100,000
Audit	40,000
Evaluation	60,000
TOTAL	20,200,000

The operational duration will be 38 months as from signature of the Financing Agreement. The undisbursed funds, if any, will be used for additional support to the TA for PFM reforms, if needed.

4.2. Budget support modalities

General, direct and non-targeted budget support.

4.3. Procurement and grants award procedures

Complementary support will mainly be implemented under Joint Management with the IMF through a Contribution Agreement in line with the existing EC/IMF Framework Agreement. All contracts signed through the Contribution Agreement must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the IMF.

For audit and evaluation, all contracts must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

Participation in the award of contracts for the present action shall be open to all natural and legal persons covered by the 10th EDF Financial Regulation. Further extensions of this participation to other natural or legal persons by the concerned authorising officer shall be subject to the conditions provided for in article 20 of Annex IV of the Cotonou Agreement

4.4. Performance monitoring and criteria for disbursement

(1) Description of performance monitoring arrangements

The PRSP implementation is monitored by the LRDC and assessed through a PRS deliverables tracking system computer programme developed by the Ministry of Planning, which also captures externally financed projects, down to the county level. In the PFM area, as GEMAP⁶ is phasing out, donor support to PFM reforms is re-centered on the basis of the PEFA joint-multidonor diagnostic and on the underlying national roadmap for PFM reforms. Taking into account the considerable amount of deliverables, and the PFM outputs required from IMF, WB, AfDB and EC budget support programmes, the EC will request the Ministry of Finance to establish a “PFM Oversight Committee”. The actual IMF TA will be reinforced with the EC TA complementary support. This will contribute to monitor implementation and secure future eligibility to the PFM related criteria. The macroeconomic outturn will be monitored closely via the regular ongoing IMF PRGF reviews.

(2) General conditions for disbursement of all tranches.

⁶ In September 2005, the NTGL and its international partners signed the Governance and Economic Management Assistance Program (GEMAP). GEMAP is a direct response to the concerns of the government and partners about the mismanagement of public resources in the post-conflict transition and its threat to the peace process. An Economic Governance Steering Committee (EGSC), chaired by the President and comprising administration officials, CBL, international partners and civil society, oversees the implementation of GEMAP. GEMAP has six components: (i) securing Liberia’s revenue base, (ii) improving budgeting and expenditure management, (iii) improving procurement practices and the granting of concessions, (iv) establishing processes to control corruption, (v) supporting institutions that are key to promoting and sustaining government accountability and good financial management, and (vi) capacity building. The government has made good progress in implementing GEMAP: it deployed international experts and financial controllers with co-signing authority to revenue-generating agencies and the CBL, and completed a review of contracts and concessions approved by the NTGL. It has strengthened public revenues and expenditure management by empowering the cash management committee (CMCo) to limit expenditures to available cash revenues, and adopted a zero-tolerance policy on corruption.

Provided that the two pre-conditions are satisfied, the three general eligibility conditions for budget support operations will need to be fulfilled for every disbursement (fixed and variable tranches). In this perspective, GoL shall communicate at the due time information on the following: i) satisfactory progress in the implementation of the Poverty Reduction Strategy (PRS); ii) satisfactory progress in the maintenance of a stability-oriented macroeconomic policy as evidenced by fulfilment of the IMF-Poverty Reduction Growth Facility (PRGF) or similar programme; iii) satisfactory progress in the implementation of its programme to improve PFM. The GoL shall use its best efforts to supply the EC in a timely manner with all the necessary information needed to formulate an assessment based on the above mentioned i) ii) and iii) points, as well as ensure dialogue around the objectives supported by this GBS program. The EC will decide to disburse on the basis of the assessment of the GoL requests.

(3) *Areas in which specific conditions for disbursement of individual tranches will be defined.*

Taking into account the eligibility criteria on PFM, the Programme foresees two pre-conditions prior to the first disbursement: (1) Regulations implementing the PFM Act have been adopted, (2) Regulations implementing the public procurement act have been adopted.

For the variable tranche, indicators on budget allocations to the health and education sectors will be introduced along with a limited number of indicators in the PFM area (one would be related to the GAC/external audit) to be identified at the occasion of a joint review with other BS partners (WB and AfDB). The final amount of the variable tranche will depend on the level of achievement of performance indicators.

4.5. Evaluation and audit

Specific external evaluations may be carried out by the EC Delegation to undertake an independent review of the provision of the EC budget support operation, at mid and end term of this GBS respectively in 2010 and after the last disbursement in 2011. These assessments will use the EC format (evaluation framework for BS operations). Evaluation reports will be shared with GoL.

4.6. Communication and visibility

Documentation in the area of budget support and PFM will be promoted to offer visibility to EC operations in these fields. Contacts with and support activities to national stakeholders, especially in respect of support to PFM reforms and budget execution will equally provide visibility to EC actions. Articles in the local press will be published to highlight EC budgetary support.