


*2024**January****LESOTHO******Components: Revenue and Spending******Modules:*** ***RM I – Tax Policy***
 RM II – Revenue Administration
 SM II – Managing Public Finances

*LESOTHO***PROJECT SUMMARY****COUNTRY:** Lesotho**LEAD DEPARTMENT:** Fiscal Affairs Department**REGION:** Africa**PROGRAM ID:** (To be filled out by Secretariat)**PLANNED DATES:** February 2024 – April 2027**FUNDING PROGRAM TITLE:** GPFP Lesotho**PROJECT MANAGERS:****RM I/TAX POLICY:** Ana Cebreiro Gomez – T2**RM II/REVENUE ADMIN:** Elizabeth Gavin – R2**SM II/MANAGING PUBLIC
FINANCES:** Alok Verma – M1**PROJECT LEAD MANAGER:****ESTIMATED BUDGET:** \$ 2,020,356**BUDGET FOR ENDORSEMENT** \$1,013,557 (through FY25)

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I. PROJECT PURPOSE

The Kingdom of Lesotho (Lesotho) requires support in implementing its revised National Strategic Development Plan (NSDP II). The Government's fiscal consolidation efforts need to continue, to avoid the deterioration of the fiscal position over the medium term. Strengthening Public Financial Management (PFM) and domestic revenue mobilization (DRM) are essential to achieve this.

On the revenue side, this project includes capacity development (CD) in both Tax Policy and Revenue Administration. Tax Policy support will focus on improving the analytical capacity of the new tax policy unit (TPU), while Revenue Administration CD will focus on strengthening the core functions of the tax administration. Following FAD recommendations through previous CD support, authorities are creating a tax policy unit under the Ministry of Finance to improve tax system design and revenue forecasting (including for the mining fiscal regime). A Tax Administration Assessment (TADAT) undertaken in March 2023 highlighted weaknesses in Revenue Services Lesotho's (RSL) core tax administration processes.

On the expenditure side, strengthening public financial management (PFM) to support fiscal consolidation is a priority for the authorities. The objective of the PFM component of this project is to improve Lesotho's PFM to achieve credible and reliable budgeting, improve efficiency, effectiveness, and the quality of fiscal reporting, and to manage fiscal risks. This work builds on wide-ranging CD provided in recent years.

The two-year project aligns with CD priorities agreed with the authorities for the medium term. The estimated budget for this two-year project is \$2,020,356, but endorsement is requested for \$1,013,557 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

II. BACKGROUND

Macro-fiscal situation

Economic growth in Lesotho has been weak and both real activity and per capita incomes have shrunk by 10 percent since 2016. Average growth of 1.8 percent in the decade 2009 to 2019 was amongst the weakest in the region and has remained well below the country's five percent target. The growth outlook remains subdued. While transfers from the Southern African Customs Union (SACU) rose between FY05/06 and FY09/10, the wage bill grew significantly too, but when transfers dipped around 2009, the wage bill remained unchanged. The fiscal balance deteriorated in FY22/23 due to lower revenue coupled with rigid expenditure. The decline in revenue was due to both lower income tax revenue and lower SACU revenues than in the previous year. Public debt increased, by 4.1 percentage points.

There is thus a need for Lesotho to contain expenditure, as well as to mobilize domestic revenue. Progress made on strengthening PFM needs to continue, to ensure efficient use of public resources, while improving governance and reducing corruption risks, and safeguarding fiscal consolidation. Domestic revenue mobilization can be enhanced through operationalizing a Tax Policy Unit and

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strengthening tax administration by addressing weakness identified through the recent tax administration diagnostic (TADAT).

IMF priority areas / cross-cutting themes

PFM CD is planned to support GovTech, gender-responsive budgeting and managing the impact of climate change, and GovTech will also be a component of Revenue Administration CD. GovTech solutions will be implemented to improve internal controls. Training and tools to support gender responsive budgeting will be provided, and training sessions will be organized to assist the authorities to quantify the long-term impact of climate change on public finances. RSL has implemented IT systems to manage and automate some of their core functions, but the functionality of these systems needs to be expanded in some areas.

Country engagement and alignment to reform priorities

Lesotho's National Strategic Development Plan for 2023/24 to 2027/28 recognizes that its current government expenditure of around 60 percent of GDP has been ineffective in meeting objectives, and that it is overly reliant on SACU revenues. Engagement with country authorities has confirmed its intent to strengthen domestic revenue mobilization, address aspects of its expenditure such as the government wage bill and improve PFM. Requests for CD have been expressed through Spring and Annual Meetings, including the most recent Annual Meeting (October 2023). The newly appointment Commissioner General of Revenue Services Lesotho has confirmed interest in a reform program to address the weaknesses highlighted in the TADAT assessment.

III. PROJECT LEVEL DESCRIPTION

A. Project Scope

This CD project is aligned with the Lesotho government's priorities outlined above and addresses key CD priorities identified by the IMF through engagement with the authorities. DRM will be strengthened through Tax Policy and Revenue Administration modules, which respectively focus on implementing and operationalizing a Tax Policy Unit (TPU) with revenue modelling and forecasting capacity and strengthening revenue collection through more effective tax administration. The PFM module in this project serves to meet the need to strengthen PFM, through improved budget processes, better fiscal reporting, and enhanced budget management.

Module RM I / Tax Policy

CD provided through the Tax Policy module will help Lesotho build capacity in tax policy design and strengthen the country's institutional capacity for tax policy monitoring and evaluation. This will facilitate tax policy reforms that can improve fiscal outcomes while supporting inclusive and sustainable growth. Expected outcomes encompass accurate forecasts of revenue collection consistent with macro-economic estimates, the development of evidence-based tax reform measures, and the preparation and publishing of tax expenditure reports.

Module RM II / Revenue Administration

The Revenue Administration module seeks to strengthen management and governance arrangements together with core tax administration processes. More effective tax administration is needed for domestic revenue mobilization in Lesotho. The first step in the revenue administration module will be the scoping and development of a phased reform strategy and plan to address tax administration weaknesses identified through a tax administration assessment (TADAT). Expected results include enhanced transparency and accountability enabled by improved data and reporting on core tax administration processes and improved compliance by taxpayers in meeting their tax obligations.

Module SM II / Managing Public Finances

The aims of CD provided through the PFM module are to strengthen Lesotho's budget credibility, and to improve fiscal transparency and reporting. Strengthened PFM is a foundation for fiscal consolidation, a priority for the Government of Lesotho. The results from CD in this PFM module will include improved disclosure of fiscal risks associated with State Owned Enterprises and climate change, the strengthening of internal controls in IFMIS, and the inclusion of gender in budgeting processes.

Table 1. Summary of Objectives covered by the Proposal

Component	Module	Objective
Revenue	RM I - Tax Policy	• Improve Tax Policy Design • Strengthen Policy Monitoring, Evaluation, and Institutions
	RM II - Revenue Administration	• Strengthen Revenue Administration Management and Governance Arrangements • Strengthen Core Tax Administration
Spending	SM II - Managing Public Finances	• Strengthen Budget Management • Improve Fiscal Transparency and Reporting

B. Country Engagement

The Government of Lesotho has made requests for support through bilateral meetings with FAD staff convened at the time of the IMF's Annual and Spring Meetings. In relation to the specific modules of this project:

- The authorities have acted upon earlier Tax Policy recommendations to establish a Tax Policy Unit, and the focus of Tax Policy CD effort will be working with the authorities to ensure that this newly established unit is fully operational and benefits Lesotho's policymaking.
- Revenue Services Lesotho, under the leadership of a newly appointed Commissioner General, has requested a support program, to address weaknesses in tax administration identified through the TADAT assessment.
- In the PFM arena, the Ministry of Finance (MoF) has benefitted from a series of CD missions on fiscal risks, GovTech, and fiscal rules and that have sensitized the MoF staff about the need for more robust PFM institutions to support fiscal consolidation. To support the MoF in this endeavor, the FAD has adopted a multipronged strategy to strengthen the PFM legal framework, introduce business process reengineering, internal controls assessment, and how GovTech can be leveraged to introduce internal controls to support fiscal consolidation. The MoF has extended

support and expressed continued interest in building on the previous CD to implement these reforms successfully.

C. Delivery Modalities

The CD delivery will mainly be in-person, due to the low capacity and culture of the country, necessitating a more hands-on approach. Virtual deliveries will be used for pre-engagement meetings and post follow-up meetings and some STX missions. The following CD activities will be delivered, and supported by program management activities under the project:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, coordinate with other CD providers, and adjust reform implementation plans.
- **Short-term expert (STX) visits** to help implement the recommendations delivered by the HQ missions. A limited number of STXs will be assigned to provide specialized training and assistance.

D. Coordination / Cooperation

This project integrates and serves to coordinate CD delivered by the IMF HQ in the areas of tax policy, revenue administration and PFM. With regard to specific modules:

- **Tax Policy:** The project team will closely coordinate with other development partners providing support at the country level, including by meeting during missions, and having regular calls as needed. Close coordination is being undertaken currently with the World Bank team during the project preparation stage, to ensure complementarities.
- **Revenue Administration:** The IMF's AFRITAC South (AFS) has provided technical assistance to Revenue Services Lesotho on debt recovery and the development of sector-specific compliance plans. The African Tax Administration Forum (ATAF) participated in the TADAT mission, alongside HQ and AFS staff. HQ and AFS will continue to coordinate, with all activities being aligned to the multi-year reform plan.
- **PFM:** CD delivery will be closely coordinated with AFS, the regional State-Owned Enterprise expert, and other donor partners (the European Union, the African Development Bank (AfDB), and the WB) to provide comprehensive and consistent CD for better PFM outcomes. AFS will provide follow-up support in macro-fiscal forecasting to develop a reliable macroeconomic framework, improving accounting and financial reporting and procurement to payment processes.

IV. RISK ASSESSMENT AND MITIGATION

General or Module	Description	Risk Probability	Risk Impact	Mitigation Measures
External climate/conditions				
General	Risk that external events create a more challenging environment to implement reforms.	Medium	Medium	Monitor closely, ensure sufficient flexibility in program execution across countries and allow for ability to adjust activities in the case of adverse events.
Political Support				
General	Lack of political support for reforms inhibits required actions.	Medium	High	Ensure fiscal risk CD is focused on priority areas and engage regularly with Ministers and senior management to ensure government ownership of reforms.
General	Uneven political ownership of reforms – tax reforms need to be accompanied by governance reforms.	Medium	Medium	Regular engagement with Ministers and senior management, to ensure full understanding of reforms required.
Management and Technical Staff Support and Commitment				
Tax Policy (RM I) & Revenue Administration (RM II)	Low commitment of management and staff to adopt and implement changes needed to the legal framework.	Low	High	Engage regularly with senior management and technical staff and explain the importance of strengthening DRM.
Tax Policy (RM I)	Gaps in capacity of management and technical staff lead to changes in priorities and ability to absorb technical assistance	Low	Low	Maintain flexibility to adjust technical assistance as needed, in alignment with skills and priorities.
Revenue Administration (RM II)	Low commitment of management and staff to adopt and implement improvements to core tax administration processes.	Low	High	Engage with senior management and technical staff pro-actively and explain the importance of strengthening core tax processes.
Managing Public Finances (SM II)	Gaps in management and technical staff capacity lead to changes in priorities and ability to absorb technical assistance	Low	Low	Maintain flexibility to adjust technical assistance as needed, in alignment with skills and priorities.

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General or Module	Description	Risk Probability	Risk Impact	Mitigation Measures
Resource Adequacy				
Tax Policy (RM I) & Revenue Administration (RM I)	Insufficient technical capacity and human resources necessary to implement reforms are limited.	High	High	Ensure CD plans include sufficient capacity building and training elements and prioritize CD to priority or highest risk areas, where resources are limited. Regular remote follow-ups, to facilitate progress.
Other risks				
General	Multiple donors are providing technical assistance on DRM and PFM, and gaps or overlaps may arise as a result.	Medium	Low	Engage with other donors to ensure support is well coordinated, through multilateral and bilateral meetings during missions, and maintaining regular contact with more active development partners.

V. CD DELIVERY PLAN COUNTRY LEVEL

Table 2. Summary of Indicative CD Delivery

CD Modalities (Remote or Field-based CD)	Total for FY24	Total for FY25	Total for FY26	Grand Total
RM I - Tax Policy				
HQ-led CD mission (incl. LTX)	1	1	1	3
STX visits (incl. LTX)	-	1	1	2
RM II - Revenue Administration				
HQ-led CD mission (incl. LTX)	1	1	1	3
STX visits (incl. LTX)	-	3	2	5
STX Remote Short	-	-	1	1
SM II -Public Finance Management				
HQ-led CD mission (incl. LTX)	-	1	1	2
STX visits (incl. LTX)	1	2	3	6
Interactive Learning	-	-	1	1

Table 3. First Year Workplan

Timing	CD Area	CD Delivery	Proposed Topics of CD
RM I - Tax Policy			
FY24 – Q4	Capacity Development	HQ (FB)	Capacity Development on revenue forecasting for TPU staff, together with RSL staff
FY25 – Q2	Capacity building	HQ (FB)	Developing microsimulation models (including data gathering) and benchmarking
FY25 – Q4	Capacity building	HQ-STX	Developing microsimulation models (continuation) and benchmarking
RM II - Revenue Administration			
FY24 – Q4	Scoping	HQ (FB);	Development of RA reform strategy and roadmap
FY25 – Q1	Training and planning	HQ-STX	Aspects of governance
FY25 – Q1	Training and planning	HQ-STX	Compliance risk management
FY25 – Q2	Training and planning	HQ-STX	VAT refund management
FY25 - Q4	Follow up	HQ (FB)	Evaluation of progress and adjustment of RA reform roadmap as needed
SM II -Public Finance Management			
FY24- Q4	Follow-up	HQ-STX	Follow-up to hackathon to introduce digital signature in IFMIS
FY25 – Q2	Follow-up	HQ-STX	Fiscal rules
FY25 - Q2	Capacity building	HQ (FB)	Fiscal risk management
FY25 – Q3	Capacity building	HQ-STX	GovTech

VI. PROGRAM FINANCIALS

	FY24 Q4	FY25	FY26	TOTAL (USD)
Direct Delivery	223,211	724,038	940,934	1,888,183
Module RM I - Tax Policy	0	138,551	236,804	375,356
Module RM II - Revenue Administration	179,355	310,407	308,923	798,685
Module SM I - Spending Policy	0	0	0	0
Module SM II - Managing Public Finances	43,856	275,079	395,206	714,142
Subtotal	223,211	724,038	940,934	1,888,183
Trust fund management fee (7%)	15,625	50,683	65,865	132,173
TOTAL	238,836	774,721	1,006,800	2,020,356

The estimated budget for this two-year project is \$2,020,356, but endorsement is requested for \$1,013,557 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

ANNEX I. REVENUE MODULE I – TAX POLICY

A. Program Objectives

The objective of the program is to help Lesotho to build capacity in tax policy design and strengthen their institutional capacity for tax policy monitoring and evaluation to support reforms that help improve fiscal outcomes while supporting inclusive and sustainable growth.

In particular, CD activities will focus on:

- Building capacity on revenue forecasting: training sessions for staff at the Tax Policy Unit (and selected staff of Revenue Services Lesotho);
- Developing and tailoring analytical tools and training materials, and building capacity within the tax policy unit to assess the trade-offs and potential impacts of tax reform measures (including the mining fiscal regime);
- Developing and operationalizing micro-simulation models to analyze impact (including by income level and sectors); and
- Developing tools to benchmark policy options according to best practices and comparable countries (e.g., main neighbors, similar level of development/capacity).

B. Expected Results (outcomes)

The CD will result in the following outcomes:

- Accurate estimates of revenue collection consistent with macro-economic estimates.
- Evidence-based tax reform measures supported with data, including economic analysis and the revenue impact of proposed measures.

C. Targeted Logical Framework – TAX POLICY

Objective	
Strengthen Policy Monitoring, Evaluation, and Institutions	
Outcome(s)	Indicator(s)
Improved structures (e.g., tax policy units) or capacity (e.g., models and tools) related to tax policy advice and analysis.	Tax policy and analysis unit is strengthened or set up.
	Models or tools developed or improved

ANNEX II. REVENUE MODULE II – REVENUE ADMINISTRATION

A. Program Objectives

Strengthening DRM is important to the Lesotho government, and effective tax administration is key to achieving this goal.

A Tax Assessment mission (TADAT) undertaken in March 2023 noted weaknesses in RSL's core tax administration functions. While the RSL has shifted focus to become more client-centric to promote voluntary taxpayer compliance, less attention has been paid to resolving issues related to core functions and the capabilities needed to respond to taxpayer non-compliance. The RSL has developed robust systems and dashboards to monitor taxpayer satisfaction and has adopted modern channels of communication with taxpayers, but at the same time, the development of IT systems supporting the monitoring and management of core processes has been slow.

The objective of the program is to work with the authorities to address identified weaknesses in core tax administration processes (registration, filing of declarations, payments and refunds, arrears management, audit) and in governance and management arrangements.

CD activities will encompass:

- As a first step, scoping and developing a phased reform strategy and plan to strengthen core tax administration processes, that will align with RSL's strategic plan. The scoping mission will also explore the readiness of the authorities to embark on a Medium-Term Revenue Strategy (MTRS), as the Government of Lesotho has expressed an interest in doing so;
- Assisting the authorities to improve institutional arrangements for monitoring and managing compliance risks, in line with the reform plan;
- Providing training in areas indicated in the reform plan as needed;
- Providing practical support for strengthening the monitoring and management of processes such as filing and payment; and
- Providing guidance on extending the functionality of IT systems to cover key core tax administration processes not yet available or activated, include the processing of Value Added Tax (VAT) refunds.

HQ-based CD delivery and CD provided by AFS will be coordinated.

B. Expected Results (outcomes)

This CD is expected to lead to:

- Appropriate institutional arrangements for managing compliance risk;
- Enhanced taxpayer compliance in respect of timely filing of accurate declarations, and meeting payment obligations; and
- Enhanced transparency and accountability through improved data and reporting on core tax administration processes.

C. Targeted Logical Framework – REVENUE ADMINISTRATION

Objective	
Strengthened revenue administration management and governance arrangements (SDG 17.1)	
Outcomes	Indicators
Capacity for reform increased due to clear reform strategy and a strategic management framework adopted and institutionalized.	Multi-year reform implementation plan, with supporting resource plan, adopted and well-communicated.
Corporate priorities are better managed through effective risk management.	Improved identification, assessment, ranking and quantification of compliance risk (TADAT POA2-3).
Objective	
Strengthened core tax administration functions (SDG 17.1)	
Outcomes	Indicators
The integrity of the taxpayer base and ledger is strengthened.	Effective management of tax accounts (TADAT 2019 POA8-27).
A larger proportion of taxpayers meet their payment obligations as required by law.	Management of refunds improved (TADAT 2019 POA8-28).
Audit and other verification programs more effectively ensure accuracy of reporting.	Appropriate range of tax audits and other initiatives used to detect and deter inaccurate reporting and fraud (TADAT 2019 POA6-19).

ANNEX III. SPENDING MODULE II– MANAGING PUBLIC FINANCES

D. Program Objectives

Strengthening public financial management (PFM) to support fiscal consolidation is a top policy priority of the Government. The objective of this program is to improve PFM to achieve credible and reliable budgeting, improved efficiency and effectiveness, quality of fiscal reporting, and manage fiscal risks. To achieve program objectives, the CD program will be focusing on building the capacity to strengthen legal and regulatory frameworks, building the capacity of the macro and budget departments to develop a macro-fiscal framework, strengthening budget institutions, implementing GovTech solutions to improve internal controls, and introducing business process reengineering, and developing fiscal risk statement.

In the medium-term, planned CD activities will:

- Provide hands-on support to build the capacity of the Private Sector Development Department (PSDD) and the Macro-Economic Policy and Management Department in better analyzing the outputs of SOEs Health Check Tool (SOE-HCT) and assist in preparing a consolidated annual SOE financial report.
- Organize training sessions for the authorities on how to consider the economic and fiscal consequences of climate change and help them to quantify the long-term impact of climate change on public finances.
- Provide support to the Treasury Department to introduce business process reengineering to improve procurement to payment processes and non-tax revenue collection process in the Integrated Financial Management Information System (IFMIS).
- Assist authorities in integrating digital signatures in the IFMIS to improve internal controls and to implement paperless PFM processes.
- Assist authorities in adopting fiscal rules. The authorities are focusing on establishing a Stabilization Fund.
- Organizing training workshops for the authorities to improve their understanding of the principles, concepts, and tools for gender-responsive budgeting (GRB) and assist them in developing a high-level GRB reform roadmap to roll out GRB in Lesotho.

Close coordination will be needed between the HQ-based CD delivery as well as with AFS to provide a comprehensive and consistent CD for better PFM. AFS will provide follow-up support in macro-fiscal forecasting to develop a reliable macroeconomic framework, improving accounting and financial reporting and procurement to payment processes.

E. Expected Results (outcomes)

The CD will result in:

- Better disclosure of fiscal risks from SOEs and climate change.
- Strengthening of internal controls in IFMIS.
- Improved PFM processes.
- Inclusion of gender in budgeting processes.

F. Targeted Logical Framework – MANAGING PUBLIC FINANCES

Objective	
Strengthen Budget Management	
Outcomes	Indicators
Strengthened annual budget process, and effective allocation	Improved allocation to priority areas including climate, gender, and SDGs
Strengthened budget execution and control processes	Improved effectiveness of budget execution and controls for non-salary expenditure including capital spending and priority areas (Record Score: PEFA PI-25. PIMA 12a)
Strengthened identification, monitoring, and management of fiscal risks	Strengthened effectiveness of management and reporting public corporation's fiscal risks including quasi-fiscal activities
Objective	
Build Fiscal Institutions and Frameworks	
Outcomes	Indicators
Strengthened fiscal policies, frameworks, institutions, and laws	Improved design and publication of fiscal rules within an appropriate legal framework (Record Score: FTC2.3.1)
Strengthened capacity to plan, implement and sustain digitalization	Strengthened functionality and/or IT architecture of PFM digital solutions