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**PROJECT PERFORMANCE ASSESSMENT REPORT**

**RUSSIA**

**TAX ADMINISTRATION MODERNIZATION PROJECT  
(LOAN 3853)**

**May 13, 2003**

*Sector and Thematic Evaluation Group  
Operations Evaluation Department*

## **Currency Equivalents** (annual averages)

*Currency Unit = Roubles*

1991	US\$1.00	170
1992	US\$1.00	420
1993	US\$1.00	1229
1994	US\$1.00	2200
1995	US\$1.00	3861

## **Abbreviations and Acronyms**

DC	Direct Contracting	NBF	Not Bank Financed
EC	European Community	OECD	Organization for Economic
DPC	Data Processing Center		Cooperation and
EDP	Electronic Data Processing		Development
EU	European Union	OED	Operations Evaluation
FY	Fiscal Year		Department
GICT	Global Information and Communication Technology Department	PCG	Project Coordination Group
IBRD	International Bank for Reconstruction and Development	PMU	Project Management Unit
		PPAR	Project Performance Assessment Report
ICR	Implementation Completion Report	PPF	Project Preparation Facility
IMF	International Monetary Fund	QAG	Quality Assurance Group
IS	International Shopping	STI	State Tax Inspectorate
IT	Information Technology	STS	State Tax Service
LAN	Local Area Network	TAMP (I/II)	Tax Administration Modernization Project
WAN	Wide Area Network	TIN	(first/second)
LIB	Limited International Bidding	TICs	Taxpayer Identification Number
LS	Local Shopping	VAT	Training and Information Center
LTU	Large Taxpayer Unit		Value Added Tax
MinTax	Ministry of Taxes and Fees		

## **Fiscal Year**

Government: January 1 – December 31

Director-General, Operations Evaluation	:	Mr. Gregory Ingram
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GREGORY K. INGRAM  
Director-General  
Operations Evaluation

**May 13, 2003**

**MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT**

**SUBJECT: Project Performance Assessment Report on Russia Tax Administration Modernization Project (Loan 3853)**

This is the Project Performance Assessment Report for the Russia: Tax Modernization Project for which an IBRD loan of US\$ 17.3 million equivalent was approved in March 9, 1995. The project closed on December 31, 2000, two years behind schedule, with US\$ 0.5 million cancelled.

The overall purpose of the project was to help develop and install an effective and efficient system of tax administration. The project had two main objectives: (a) to pilot reforms of the State Tax Service (STS) in two regions with about 110 local offices through (i) reorganization of structures, (ii) introduction of new procedures, (iii) automation of tax systems, and (iv) staff training; and (b) to assist in the institutional development of tax administration by (i) building the capacity of the STS, (ii) preparing for nationwide implementation of reforms in tax administration, and (iii) providing support for project management.

OED rates the project's overall outcome as satisfactory, its sustainability as likely, and its institutional development impact as substantial. Project objectives were complex and demanding, given the limited institutional capacity and unfamiliarity of the client with the Bank at that time, the fast changing environment of a transition economy, and the comprehensive reforms and institutional changes involved. But the objectives were highly relevant, the pilot approach was necessary, and implementation ultimately met and exceeded the original objectives. Project design was significantly revised to incorporate new ideas and learning from implementation, as would be expected for a pilot. Efficiency suffered somewhat, but relevance and efficacy were high. While total project costs remained the same, the restructuring of the technical assistance component agreed at the midterm review yielded savings that were used for expanded training and equipment purchases. Sustainability is rated likely (rather than highly likely) because of challenges to continuous institutional learning, and because project outcomes were in part the results of exceptional efforts by a few individuals rather than managerial systems that were institutionalized, and thus the risks are significant when scaling up.

OED rates the Bank's overall performance as satisfactory, despite relatively poor preparation and problems that almost led to cancellation, since this was a pilot project, designed and implemented under very demanding circumstances. Supervision was exemplary and the task team was flexible and open to learning. Similarly, OED rates borrower performance as satisfactory since its highly satisfactory performance in the final two and a half years of implementation more than compensated for the highly unsatisfactory performance in initial implementation.

The main lessons learned are particularly relevant to pilot projects and those involving major computerization and organizational reforms, namely:

- **Ownership can be built from the bottom up.** Ownership can be engendered by demonstrating change from the bottom up, using regional pilots and judicious sponsorship from the top. Large-scale top-down institutional reforms may not be an option from the outset, particularly for large countries with diverse regions, when headquarters are distant from client services and local problems, and when there are strong vested interests in the status quo and fear of change.
- **Piloting** is judicious when there is a need for integrating comprehensive and complementary reforms on a scale where complexity and risks are manageable and early results are necessary.
- **Strategic management, including sequencing of hardware and software and organizational change activities** are important in introducing large-scale computerization. In particular, attention should be given to software development prior to any substantial investment in hardware.
- **Bank procurement procedures should be adapted to** deal with the relatively unpredictable but critical process of customized **software development**.
- **Social marketing** and image building are important activities to facilitate change in client behavior and to scale up institutional reform efforts.
- **E-government programs should build on local experience** with pilot computerization and organizational change, and on and the technical platforms and standards already established. The experience gained from the modernization of focused institutions and strategic processes such as tax administration should guide national strategies for diffusing information and communication technologies on a broader scale.

Attachment

## OED Mission: Enhancing development effectiveness through excellence and independence in evaluation.

### About this Report

The Operations Evaluation Department assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the Bank's self-evaluation process and to verify that the Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, OED annually assesses about 25 percent of the Bank's lending operations. Assessments are conducted one to seven years after a project has closed. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons. The projects, topics, and analytical approaches selected for assessment support larger evaluation studies.

A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by OED. To prepare PPARs, OED staff examine project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader OED studies.

Each PPAR is subject to a peer review process and OED management approval. Once cleared internally, the PPAR is reviewed by the responsible Bank department and amended as necessary. The completed PPAR is then sent to the borrower for review; the borrowers' comments are incorporated into the document that is sent to the Bank's Board. When an assessment report is released to the Board, it is also widely distributed within the Bank and to concerned authorities in member countries.

### About the OED Rating System

The time-tested evaluation methods used by OED are suited to the broad range of the World Bank's work. The methods offer both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. OED evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (complete definitions and descriptions of factors considered are available on the OED website: <http://wbln1023.worldbank.org/oed/oeddolib.nsf/232d43ae09e87ac985256966007cc257/acaeb95358e99e578525698c005190da?OpenDocument>).

**Relevance of Objectives:** The extent to which the project's objectives are consistent with the country's current development priorities and with current Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, Country Assistance Strategies, Sector Strategy Papers, Operational Policies). *Possible ratings:* High, Substantial, Modest, Negligible.

**Efficacy:** The extent to which the project's objectives were achieved, or expected to be achieved, taking into account their relative importance. *Possible ratings:* High, Substantial, Modest, Negligible.

**Efficiency:** The extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. *Possible ratings:* High, Substantial, Modest, Negligible.

**Sustainability:** The resilience to risk of net benefits flows over time. *Possible ratings:* Highly Likely, Likely, Unlikely, Highly Unlikely, Not Evaluable.

**Institutional Development Impact:** The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

**Outcome:** The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

**Bank Performance:** The extent to which services provided by the Bank ensured quality at entry and supported implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of the project). *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

**Borrower Performance:** The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development objectives and sustainability. Possible ratings: Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.



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This report was prepared by Nagy Hanna, who assessed the project in March 2002. The report was edited by William Hurlbut. Helen Phillip provided administrative support.



## Principal Ratings

	<i>ICR</i>	<i>ES</i>	<i>PPAR</i>
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Highly Likely	Likely	Likely
Institutional Development Impact	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

## Key Staff Responsible

<i>Project</i>	<i>Task Manager/Leader</i>	<i>Division Chief/ Sector Director</i>	<i>Country Director</i>
Appraisal	Carlos D. C. Ferreira	Robert Liebenthal	Yukon Huang
Completion	Richard Johanson	Pradeep Mitra	Julian F. Schweitzer



## Preface

This is a Project Performance Assessment Report (PPAR) for the Russian Federation Tax Administration Modernization Project (Loan 3853) for which a Bank loan in the amount of US\$17.3 million equivalent was approved on March 9, 1995. The project closed on December 31, 2000, two years behind schedule, with US\$ 0.5 million cancelled. An implementation Completion Report (ICR) was submitted on June 15, 2001.

This PPAR was prepared by the Operations Evaluation Department (OED) based on the ICR, the Staff Appraisal Report, a review of Bank files, and extensive discussions with Russian policymakers and implementing agencies, Bank staff, consultants, and cofinanciers. The cooperation and assistance of all stakeholders and government officials is gratefully acknowledged, as is the support of the staff of the World Bank Country Office in Russia.

This PPAR complements and builds on an excellent and detailed ICR. It focuses on lessons and future directions, since the project presents rich lessons of critical relevance to country assistance strategy and for Bank involvement in scaling up the tax administration modernization and other government services modernization programs. The PPAR also gives special attention to the role and modality of pilot operations and the institutional change issues involved in major computerization and business process reengineering.

Following standard OED procedures, the draft PPAR was sent to the borrower for comments, none were received.

## Background

1. The overall purpose of the Tax Administration Modernization Project (TAMP) was to help develop and install an effective and efficient system of tax administration. The project had two main objectives:

- to pilot reforms of the State Tax Service (STS) in two regions with about 110 local offices: through (i) reorganization of structures, (ii) introduction of new procedures, (iii) automation of tax systems, and (iv) staff training;
- to assist in the institutional development of tax administration by: (i) building the capacity of the STS, (ii) preparing for nationwide implementation of reforms in tax administration, and (iii) providing support for project management.

2. The project aimed to support the rapid reform of tax administration in response to an unquestionably important requirement for fiscal stabilization and growth. The project responded to an urgent requirement to improve tax administration in the context of major fiscal imbalances. It was added to the lending program relatively late, and was prepared and appraised in less than six months—a quick and appropriate response.

3. TAMP achievements and limitations should be viewed in the context of overall Bank assistance to Russia during the 1990s and the formidable obstacles that faced the country's transition to a market economy. The project was designed during a time of limited Bank knowledge of country conditions, where institutional constraints to project implementation were not understood or amenable to easy solutions, when the risks of large-scale Bank lending were high, and when there was little national consensus on the pace and direction of socio-economic transformation. Although project performance suffered from this overall environment until 1998, it turned around earlier than the rest of the Bank's portfolio, and provided lessons and demonstration effects that should benefit the scaling up of the tax modernization program and the overall implementation of e-government and eRussia.

4. Although envisaged as a computerization project, the Bank and the State Tax Service (STS) and its successor the Ministry of Taxes and Fees (MinTax) learned that this is essentially about complex institutional change, where issues of leadership, organization, roles, skills and attitudes, are the most critical factors for improving performance. *Information technology was viewed progressively as a catalyst for holistic change.* The Bank and the Government moved ultimately, albeit belatedly, to put overdue emphasis on training and institutional development.

## Project Design and Implementation

5. The TAMP consisted of the following two main components: piloting administrative reforms in two regions and institutional development.

### ***Piloting Tax Administration Reforms in Two Regions***

6. This component covered three elements:

- *Piloting.* Organization and Procedural Reform. The project sought to introduce a functional organization in STS local and regional offices and simplify procedures by adopting a self-assessment system and instituting a system for audits. Taxpayer education was to be instituted through dedicated staff and the organization of seminars and a public information campaign.
- *Automation.* The project involved: (i) computerizing the tax processing of the major taxes, specifically, the Value Added Tax (VAT) and profit tax; (ii) simplifying tax forms to make them ‘user-friendly’; (iii) acquisition and installation of computer hardware for two regional offices and 110 local offices.
- *Staff training.* The project included the development and delivery of staff training programs in taxpayer education, audit, tax collection and computerization. Targets: 32,000 staff-days of training within Russia, and 220 senior tax officials for study tours outside Russia.

### ***Institutional Development of Tax Administration***

7. This component covered also three elements:

- *Organizational development.* The project included financing for studies and plans as follows: preparation of a tax administration strategy, plan for reorganization of STS headquarters, strategy and protocol for cooperation among key agencies involved in taxation, taxpayer education strategy, a national audit plan, a national training plan, and a review of the legal and regulatory framework.
- *Preparation for nationwide implementation.* The project included an independent review of reform implementation in the two regions, development of national guidelines and standards on tax modernization, preparation of a national automation strategy, a feasibility study on individual taxes and preparation for expansion of piloted reforms to other regions.
- *Project management unit support.* Establishing and strengthening the expertise of the Project Management Unit with a view that some of its functions, e.g., procurement, taxpayer education, Electronic Data Processing (EDP) development and evaluation, would become permanent features of the STS.

### ***Revised Components***

8. Several new project elements were added during project implementation:

- Two separate Data Processing Centers (DPCs) were included in the project, one piloting enterprise taxes in Volgograd and one piloting personal income taxes in Moscow. The idea for DPCs arose from the evaluation of the effectiveness of tax administration in the two regions as financed by US Agency for International Development (USAID). Some tax processes could be done on an inter-regional basis, effectively consolidating processing into larger units, thereby achieving economies of scale and greater efficiency.

- Additional assistance was provided to the headquarters to install a corporate network and Local Area Network (LAN). This corrected one of the weaknesses in the original design, namely that the headquarters had no direct assistance and little direct stake in the project
- Automation support was provided for Large Taxpayer Units (LTU). The LTU was a new concept proposed by the International Monetary Fund (IMF) to accelerate revenue collection in the short run from the biggest taxpayers.
- The processing of personal income taxes was added to the project through the Moscow Data Processing Center (DPC).
- The technical assistance program was reformulated and reduced. Several plans and analyses were eliminated as no longer needed in the view of the STS; others were added such as increased staff training.

9. Modifications to project components reflected flexibility on the part of the Bank to respond to new ideas and correct some of the deficiencies in the original design, and are consistent with the concept and aim of a pilot project. The changes were not considered to be a major restructuring of the project since the objectives and most of the components remained the same. Although significant, the changes were seen as reallocation to alternative means to accomplish the development objectives of the project.

### ***Assessment of Design***

10. Identification of design weaknesses can be seen as a positive outcome of the pilot approach that sought lessons from experience on a small scale in order to improve interventions for nationwide implementation. Given the sense of urgency and limited preparation time, and the Bank's unfamiliarity with Russia at the time, it is difficult to judge whether a more rigorous design process would have averted or fully appreciated the risks. A pilot approach was therefore essential. But such an approach should have also committed the Bank to provide adequate resources for timely supervision and learning, and different formal modalities for reviewing and adapting than the Bank's standard ways of doing business for projects. The MinTax and the Bank lacked a clear strategy to test or pilot--it emerged later in implementation. There was little thinking about business logic and information architecture prior to procurement, or about sequencing among hardware, software, reorganization, training, and other elements of change.

11. The Tax Administration Modernization Project (TAMP) was examined by the Quality Assurance Group (QAG) in 1997/98. This review rated quality at entry as "marginally satisfactory, but with an important caveat." (QAG, p. 9) "The project was an urgent priority. It was added to the lending program at the last minute, prepared in less than six months and at a very low cost (under \$100,000). Project design as a pilot was appropriate. The capacity building components (TA and training) were ambitious but suited to needs" (QAG, Annex 6, p. 3) "why, then, was the quality at entry less than fully satisfactory. The foundations of the project proved to be built on clay. The STS leadership almost immediately turned hostile to outsider involvement. The project design was based on an IMF-EU pilot operation under implementation at the time of appraisal

and not sufficiently well evaluated. It subsequently failed. In summary, the usual predictors of project success -- borrower commitment, realistic project design and institutional capacity -- were absent almost from the beginning". (QAG, Annex 6, p. 2)

12. Greater ownership of the reforms would certainly have led to quicker solutions to problems. The commitment of the central government to the project also overestimated: STS senior management, under immense pressure for immediate increases in tax revenues, then had little time for a project with deferred payoff. The concept of the intended reforms under the project was not fully understood or appreciated initially by top management in tax administration. Hence, low priority was accorded to the project during initial implementation.

### ***Assessment of Implementation***

13. The project experienced a major turnaround, from being close to cancellation, to a success story. The project took two years longer to implement than originally planned, that is 5.5 years instead of 3.5 years, a time overrun of 57%. The project effectively was under suspension for one year - disbursements virtually ceased in 1996. A tentative agreement was reached with Russian authorities at the Bank-IMF Annual Meeting in October 1996 to cancel the project, subject to a formal decision by The Interministerial Commission. In the meantime project supervision was suspended. However, the government decided in 1999 to resuscitate the project rather than cancel it and nominated a better team to manage the project. Significant improvement came with the appointment of the new team, which included experts from the private sector to strengthen and improve project implementation.

14. The project was initially plagued by procurement problems arising from inadequate evaluation by the Bank of the prototype applications software in the Moscow region on which the regional pilots would be based. The unexpected failure of the prototype (finance by IMF-EU) required redesign of software, and *revealed inadequacies in the hardware that was procured ahead of the software*. Procurement of equipment was well advanced at the start of the project. Bidding documents and equipment specifications were prepared early, bidding took place in late 1995, and the Bank gave its "no-objection" to a major contract for equipment in 1996. However, award of the contract was postponed pending: (a) completion of software, and (b) the STS securing resources to finance import duties and taxes. The contract was only awarded in 1998 after the project was restarted. By the time the project was reactivated the winning vendor no longer manufactured the specified equipment. Following negotiations the vendor agreed to provide its latest equipment, two generations younger than the original bid offer, without cost increases. Development of software was so protracted, however, that the equipment ended up being purchased before it was completed and tested. Full implementation of the software revealed inadequacies in some of the hardware that will have to be addressed as equipment is replaced and renewed.

15. Several factors explain the slow pace of initial project implementation:

- The Project Coordination Unit had little capacity and experience and low level of authority. Day-to-day management of the project was not the responsibility of a

sufficiently senior official until 1998, when the Unit was strengthened and integrated with the authority structure of the STS.

- The prototype applications software failed. This meant new software needed to be developed, and caused a cascade of events that delayed implementation.
- The STS was unable to find sufficient local funds to finance software development by its subsidiary organization, GNIVTS, and the Bank could not finance the work because of procurement rules (as GNIVTS was wholly owned by the STS).
- Hardware procurement was delayed, not only to allow software development to catch up, but also because the STS could not find counterpart funds to pay for import duties and taxes on the equipment until the project was restarted.
- Lack of funds was a reflection of the lack of understanding and therefore commitment by senior STS management as to the overall goals, objectives and strategies. This lack of support prevailed until appointment of the former Minister of Finance as STS head in 1998.
- Top management was under severe pressure to raise tax revenue immediately, and had little or no incentive to spend time and attention on a project that would realize benefits only in the medium term.

16. Problems experienced by the regions in the introduction of the new structures and processes included the following: (1) apprehension on the part of staff in changing working habits, (2) reluctance of tax inspectors to break personal relations with taxpayers, and vice versa (as they have a personal interest), (3) trouble in standardizing tax procedures under fast changing tax laws, (4) the inability of the structure of the MinTax headquarters to support financially the functional organization of local tax bodies, (5) lack of an independent network of specialists to advise taxpayer clients on tax matters, (6) inadequate postal service, hindering contact-free filing of tax records, and (7) lack of a uniform state policy on tax education and voluntary compliance. One of the main problems was the lack of cooperation and interaction between project groups in pilot regions and headquarters early during implementation.

17. Several factors explain why the project turned around from 1999 onwards:

- Change in the enabling environment, appointment of new leaders--particularly of a deputy minister who supported the reform, and demonstrated results at the local level.
- Continuity in Bank staff supervising the project, and increased Bank supervision budget that permitted expansion of the supervision team.
- Attitudes and skills of the task team leader--building partnership, taking risks, providing hands on advice, and pushing back the bureaucracy. The engagement of the Russian Executive Director and of long term advisors were also contributing factors.
- Inclusion of components that would benefit the STS headquarters directly (corporate network) thereby giving them more of a stake in the project, and reinstatement of the Moscow region where STS officials could see tangible results.

- Strategic technical assistance to the STS for the modernization program, especially US assistance, which influenced top policy makers and provided new ideas.
- Well-designed study tours that exposed Russian tax authorities to efficient tax operations in other countries. This led to far better understanding of the new practices being implemented, e.g. DPCs and taxpayer services.

## Outcomes

18. The TAMP was a significant step towards an effective and efficient national system of tax administration. It developed key tax processes and applied them in pilot regions. A functional organization was installed in two pilot regions. This structure has been standardized and adopted for national deployment. Software was developed for processing most all taxes. Appropriate hardware was acquired for automation of tax processing. Staff was trained in the new processes. Between 1996 and 2000 the two pilot regions made a breakthrough from almost nonexistent information services to a wide range of services provided to taxpayers. Moreover, the tax administration prepared a variety of technical strategies and programs for national implementation of tax reforms.

19. The TAMP achieved virtually all its objectives, albeit in a longer time frame than originally planned. The delays allowed new initiatives to be incorporated into the project, including regional data processing centers and an increased array of taxes. Overall, significant learning and capacity were generated for implementation of reforms in tax administration on a wider scale.

20. The TAMP has raised the level of tax discipline, as indicated by the following quantitative indicators of *improved tax compliance*.

- The proportion of tax returns filed on time increased from an average of 50% to 75% between 1998 and 2000. The share of voluntarily submitted documents grew by 18% over the same period.
- In Volgograd, the share of voluntary tax payments in total tax receipts has increased steadily from 35% in 1996, to 45.2 % in 1999 and 60% in the first nine months of 2000. Corresponding figures for Nizhny Novgorod were 49% in 1999 and 62% in 2000.
- The tax collection/GDP ratio of Volgograd was below the national average in 1997 (7.8% compared with 10.1% for the country as a whole). In 1999, it exceeded the national average for both federal and regional taxes (9.6 % compared with 9% for the country as whole). Moreover, tax revenues as a share of the regional budget increased from 11.3% to 14.7% over the same period.
- In Nizhny Novgorod, tax collection from the largest 58 taxpayers increased by 150% between 1996 and 2000.
- Recovery of tax arrears improved markedly during the project. Between 1998 and 2000 arrears rate fell 90% in Nizhny Novgorod and 170% in Volgograd. In 1999 Nizhny Novgorod collected 1.4 times more of the taxes in arrears than in 1998, and Volgograd collected 2.2 times more tax arrears.

- In Moscow collections from personal income taxes more than doubled because, for the first time, authorities were able to match information about salaries paid by firms with individual taxpayers. In addition, experimentation is being done with electronic filing.

21. The project also achieved the following improvements in indicators of ***administrative efficiency***.

- The average quarterly revenues per staff member grew by 157% between 1998 and 2000 in Volgograd, and by 78% over the same period in Nizhny Novgorod.
- The number of tax returns and other records being filed with errors declined two-fold. The number of entry errors declined from 25% to 5%.
- Processing efficiency increased by a factor of four, from 40 to 160 documents per month per employee.
- Document processing speeded up, with processing time for a typical tax document being reduced on average from 15 minutes to 3 minutes.
- The time to respond to inquiries by taxpayers was cut from 2 weeks to 1-4 days, and 30% of the requests were served within 24 hours.
- The average time between identification of tax violations and taking corrective measures (issuance of collection letters) was reduced from 10 days to three days.
- The time spent per taxpayer during the filing season was reduced nine fold.
- Waiting time by taxpayers for service was shortened by 5 to 6 times.

22. This was achieved without increased numbers of tax administration staff. The number of employees responsible for data entry, processing and outputting decreased by 15% while the volume of processed data increased by a factor of three. The labor input for preparation of statistical reports remained constant but the volume of such reports doubled. About 30% of employees were relieved of monotonous and routine operations to be engaged in functions requiring more skill. The share of routine operations decreased by half.

23. The project exceeded original expectations in several important areas. These included:

- Scaling up the reorganization to cover all local centers, starting July 1, 2001.
- Expanding the numbers and types of taxes under automation.
- Establishing of two Data Processing Centers, one to take advantage of economies of scale.
- Developing of Large Taxpayer Units (LTUs) in six regions to concentrate resources and attention on the taxpayers that provide most of the revenue.
- Developing a corporate network at STS headquarters and the basis for a wide area network that can connect the whole country.

24. The weakest performance pertained to organizational development at STS headquarters and the completion of various studies and strategies. Four components achieved their objectives only in part, including the reorganization of the headquarters, preparation of a strategy on interagency cooperation, development of a national training

plan and review of the legal and regulatory framework. Some important results were produced under each component, but not to the extent envisaged originally under the project. In retrospect, reorganization in headquarters was probably premature and had to await functional reorganization in the regions.

### ***Piloting of Tax Administration Reforms in Two Regions***

25. *Introducing a functional organization in STS offices.* Functional organizational structures have been introduced in 107 local offices while 3 offices have been closed in Nizhny Novgorod and Volgograd. Nizhny Novgorod also piloted the consolidation of smaller rayon offices into four more viable inter-rayon offices. The organizational structure of the Regional Offices in the two pilot regions broadly follows that of the local offices. The functional organizational structure was evaluated by Georgia State University in December 1998 and recommendations were made for further refinement.

26. *Adopting a self-assessment system.* Self-assessment has been introduced in the pilot regions. Tax returns are now prepared by taxpayers who also calculate taxes due. Taxpayers have the option to file returns by mail. Taxpayer service units have been established to assist taxpayers where needed. But, achieving a fully functioning system of self-assessment inevitably is a long-term proposition. Much more work needs to be done on taxpayer and on developing third-party verification for the income of firms and nonsalaried individuals.

27. *Instituting a system for audits.* In the large tax inspectorates of the pilot regions, units have been established for the planning of tax audits. ‘Guidelines for Tax Compliance Activities’ was developed. The new software used in the pilot regions has a module to enable automated selection of cases for audit. Staff have been trained in basic audit techniques by other donors, and by a local training firm using project funds. Still, further improvements are needed.

28. *Introducing various forms of taxpayer education.* Extensive efforts were made by both pilot regions to educate taxpayers and develop a tax compliance culture. A taxpayer association was created in Volgograd to advocate the rights of taxpayers.

29. *Computerizing the processing of the VAT and profit tax.* The project results went much beyond tax processing for VAT and profits taxes and covered all types of enterprise taxes, as well as a start on personal income taxes in all three regions. Moscow has established a centralized processing center using personal income taxes and individual numbers. In this process, the project helped simplifying tax forms to make them ‘user-friendly’. GSU provided assistance in developing new returns forms for VAT and personal income tax. The forms can be readily adopted countrywide. The project completed the acquisition and installation of computer hardware for two regional offices and 110 local offices.

30. *Creating Data Processing Centers* under the project, in Volgograd and Moscow to achieve economies of scale in processing tax forms and information. These centers enable the arms-length processing of taxes which is of fundamental importance to reduce corruption, as it eliminates the contact between tax inspectors and the taxpayer. Also, a

corporate network was established successfully at MinTax headquarters to facilitate communications among the various units in the tax administration. Six LTUs were computerized to handle the taxes of significant enterprises.

31. *Developing and delivering staff training programs in taxpayer education, audit, tax collection and computerization.* This was achieved relatively late in the project. Functional training started earlier with government funding, but data processing and management training started later. Five computerized training classrooms were established in the two pilot regions. The amount of persons days of training was virtually the same as the original project target of 30,000. Both Nizhny Novgorod and Volgograd established Training and Information Centers (TICs) as self-sufficient entities having the status of unitary enterprises for conducting educational and publishing activities in new tax processes and advanced management training. The Bank financed training provided by a Russian firm in training managers, tax inspectors, and system administrators. In addition, late in the project a 50 officials of MinTax headquarters and the pilot regions undertook a total of six study tours to observe reform measures in practice, such as consolidation of offices, centralized data processing and functional organizations.

### ***Institutional Development of Tax Administration***

32. *Institutional development was at the heart of this pilot, but was somewhat eclipsed by the major focus on hardware acquisition and software development.* Institutional development covered strategy development organizational restructuring, interagency cooperation, taxpayer education, and several studies. Three progressively refined strategies have been prepared.

33. Organizational development at tax administration headquarters was partly achieved. The most significant organizational change during the project period was the creation of a Tax Modernization Department that reports directly to the Minister. In addition, the following units have also been created since 1995: Department of Information Policy, an auditing unit, taxpayer registration department, a unit for LTUs and an office for human resource development. More subtle yet profound is the beginning of a broader change in the organizational culture of the Ministry.

34. Early in project implementation a reorganization plan was developed that called for transition to a functional organization, mirroring the functional organization in the two pilot districts. However, this could not be implemented during the life of TAMP and was not officially adopted. Two problems impeded reorganization of the tax administration headquarters. First, functional organizations. The other regions followed traditional lines of organization. Therefore, the headquarters would have had two conflicting organizational structures. However, now the MinTax has adopted a common functional organizational structure and is applying it to all regions and tax inspectorates as well as at headquarters. Second, a functional organization is likely to have substantial staffing implications, and may require as many as three to four times the staff in headquarters than at present. Based on staffing ratios between center and periphery in other countries, functional organizations have about 2-3% of total staff at the center to manage each function, monitor execution and prepare training, etc. In Russia at present the headquarters has only 0.5% of the staff at headquarters (900 staff vs. about 150,000

employed in the regions). The increased staff at headquarters can be offset partly by reductions in staff required in the regions under the functional organization. This could be complemented by a policy of relocation and rotation between field offices and headquarters.

35. This project also aimed to develop strategy and protocol for cooperation among key agencies involved in taxation, partly achieved. Interagency cooperation in sharing of data is vital for independent verification of self-assessed tax returns. Under this component a formal strategy was never prepared, but progress was made nevertheless in response to immediate needs. Progress occurred at two levels: (1) Guidelines for Tax Compliance Activities were developed jointly by the MinTax, the Federal Tax Police and the Ministry of Interior. (2) Formats for exchange of information have been agreed with the State Statistics Committee, Treasury and Customs. At the regional level the two pilot areas have made separate agreements to obtain information on local registrations (real estate, automobiles). The 1999 Tax Code made the sharing of information between agencies mandatory.

36. Excellent taxpayer education strategies have been adopted by pilot regions including formal training classes for taxpayers, consultation by phone or in person, in-depth technical assistance for a fee, TV, newspaper and radio campaigns and educational programs in school to teach young adults about taxpayer responsibilities.

37. During implementation a new audit strategy was prepared and adopted. The IMF provided technical assistance to review auditing and made recommendations for reforms early in the project (1995). An information system was installed to identify taxpayers for auditing, use of third party information including information from tax agents to identify candidates for audits. Staff training in auditing was provided to help implement the strategy.

38. The highly positive outcomes of training (such as in facilitating change) have convinced tax authorities that training is an essential ingredient in the introduction of new business processes, and that it must be given early in implementation. Training was not a common tradition in the government. But it is now a strong felt need in the MinTax, in part to cope with rapid organizational and role changes. The project succeeded in creating core-training programs for both technical personnel and managers, with corresponding teaching materials. These can be used to introduce reforms in tax administration throughout the country. A more comprehensive national plan and permanent training programs is under development and will be implemented under a current EU/TACIS project and the proposed Second Tax Administration Modernization Project (TAMP II). Plans to use distance education are also underway. The MinTax created a directorate for training and appointed a dynamic director. A systems approach to on-the job training and management development is critical to sustain organizational change.

#### ***Preparation for nationwide implementation.***

39. A key output of the project was to prepare for nationwide implementation of the reforms carried out in the pilot regions, thus spreading the administrative efficiency and tax compliance gains to other regions. In December 1998 GSU evaluated the IT,

application software and tax administration procedures in the project regions. The software and related procedures were redefined and improved in accordance with recommendations. The development of national guidelines and standards on tax modernization was achieved. Initial work was financed by the United States Trade Development Agency under the “re-engineering procedures.” Hardware, software and application systems have been developed and can be used under a second project. De facto standards were established in the pilot regions and for LAN/WAN at headquarters.

40. A national automation strategy was prepared early in the project, and has been revised several times to take into account recent developments. It is being further reviewed and refined as part of the preparation of the second project. Meantime, the preparation of the third phase of the program is being developed at a much higher level of detail than originally planned. It is being financed through grants (USTDA and a Japanese PHRD grant).

41. Project management and integration remain the major vulnerability in scaling up the pilot reforms to nationwide implementation. The project aimed to establish and strengthen the expertise of the Project Management Unit with a view that some of its functions, e.g., procurement, taxpayer education, EDP development and evaluation, would become permanent features of the STS. The original Project Coordinating Unit (PCU) was a relatively weak organization. It could not attract highly qualified staff. At the time the project was resuscitated in 1997 the STS considered the establishment of an external PCU, but was prevented from doing this by legal issues and time required. Instead it took a hybrid approach. An internal group within the STS was designated to work with an external group of consultants (Project Coordination Group, PCG) on the project. While not ideal, this arrangement strengthened the overall competence of the PCU and allowed the completion of the project. PCU staff was also strengthened through external study tours. Under the project considerable build-up of expertise occurred within the STS in procurement, and in the technical capability of its subsidiary, GNIVTS. But program management systems are not yet well developed.

42. MinTax has been impressed enough with the results of the pilots (under TAMP I) that it has already proceeded with preparing to scale up the program to cover the larger federations, not awaiting TAMPII approval. Currently, a unified software is being introduced to support the new functional organization in the other regions. The delay in preparing TAMPII since TAMP I was completed has *allowed more time for the MinTax to digest the lessons learned and to attend to the necessary preparation of training, and other soft investments needed to effectively absorb the next wave of technological investment.*

### **Costs and Financing**

43. A decision was taken about the time of re-evaluation of the project in 1997 to shift most of the costs for external consultants to another donor willing and able to fund it – the US government. The remaining allocation in the loan funds for technical assistance was then used to finance assistance for the Project Coordinating Unit external training and local training. Excluding the technical assistance (TA) provided by the US, project costs remained approximately the same as originally planned. Savings were used to buy

equipment for components added to the project (particularly for the DPCs, Corporate Network and LTUs) and to finance more local training than originally planned.

44. The final disbursements (below) show that they closely corresponded to the original plan.

Category	Original Allocation (\$)	Actual Expenditure (\$)*	Variation (%)
Goods	13,900,000	14,800,000	+6.5%
Consultants' services including training and fellowships	1,800,000	2,000,000	+11.1%
Refunding of Project Preparation Advance (PPF)	500,000	0	
Unallocated	700,000	0	-100%
Total	16,800,000	16,800,000	0

## Ratings

### *Outcome: Relevance, Efficacy and Efficiency*

45. Project objectives were central and remain highly relevant to resource mobilization and economic management. Despite poor start, crises, and delays, the project exceeded its original objectives, in terms of outcomes achieved: improved tax compliance, increased administrative efficiency, and demonstration effects. The project was efficiently prepared, but efficiency suffered during implementation. However, that may be in the nature of pilots and learning processes. So, on balance, project outcome is satisfactory.

### *Sustainability*

46. This assessment rates sustainability as likely. Government commitment for the project, and for nationwide implementation of the project reforms, has been strong over the last two and a half years of the project and has been sustained since pilot implementation completion, spanning the terms of four different Ministers. Management capability has been built and demonstrated over the past two years within the STS and the Project Coordination Unit. Provided these levels of commitment and competence are maintained, the project benefits (higher productivity, higher tax collection, taxpayer time saved) are likely to be sustained in the regions, and can be progressively extended throughout the country. But vigilance is needed to sustain and scale up these reforms.

47. A base has been established for nationwide implementation of key reforms in tax administration. The MinTax's top leaders now "own" the project. The planned second project, about to be launched, will extend the reforms to more regions with a view to eventual national implementation. This would reinforce sustainability. A key factor in sustaining project benefits and extending them to new regions is the emphasis on more and better staff training. The tax administration organization has 150,000 staff and a

turnover of 8% p.a. This means that 12,000 new staff must be trained each year, as well as training to update 18,000 existing staff. A major effort is required to develop standard training programs, finance efficient forms of delivery, evaluate training impact, and make further modifications to improve training progressively.

48. The benefits of a functional organization, self-assessment and good automation have already been demonstrated in the pilot regions. Continued support for equipment upgrading, revising software and taxpayer education will be necessary in the two pilot regions to maintain the benefits of the reforms, even while taking these reforms to national scale. First, the functional organization has been standardized and is currently being extended throughout the country. Second, as a bridge between the first and second projects the Ministry has been introducing at its own expense reformed structures, new business procedures (e.g. self-assessment) and new software in eight new regions during 2001-2002. Third, the second tax administration project will help deepen the reforms.

49. Sustainability is rated likely rather than highly likely since there are many risks as the pilot is expanded to the national level. Project outcomes were the results of exceptional efforts by a few individuals rather than adequate managerial systems put in place, and thus the risks of maintaining and scaling up these changes are significant. Vigilance of policymakers and the Bank is critical to sustainability as these reforms are taken to national scale, covering diverse and remote regions and vast geographic areas. Suitable indicators have been developed under the project for monitoring the further implementation of reforms in the regions. The areas in which more attention is needed are further strengthening and integration of project management systems within the MinTax, development of monitoring indicators for institutional development in the MinTax development of more extensive taxpayer advisory services, communications with and within the more remote regions, and massive reorientation and training.

*50. A key benefit from a pilot project is learning, particularly institutional learning, but the sustainability of such learning cannot be taken for granted here. The Bank is pressed to move with speed to finance a much scaled up modernization project, and therefore may not be inclined to probe deeper into the lessons to be learned and the weaknesses that could be further revealed from the pilot. The MinTax is sensitive to outside criticism and may view some of the remaining challenges or revealed weaknesses as a major mistake to be hidden or a threat to the speed needed to get the Bank's proposed follow up financing. But sensitivities that prevent further probing could abort future learning and lead to longer term problems. It is therefore critical to create an environment that facilitates continuous institutional learning in the face of major computerization and continuous institutional change.*

### ***Institutional development impact***

51. The project is institutional development impact was substantial for the pilot regions. The implementation of a functional organizational structure in the two pilot regions had led to significant improvements in the functioning of the tax administration, including:

- Elimination of duplication of functions between different organizational units.

- Tax inspectors have been relieved of routine work, enabling them to concentrate on taxpayer services and tax compliance.
- The new structure has separated taxpayer service activities from those involving decisions on taxpayer liabilities, thus reducing the scope for corruption.
- Professional skills have been strengthened by allowing staff to specialize in specific functions.
- The relationship between tax administration and the taxpayers has improved through the creation of special units to deal with taxpayer service.
- Waiting times for taxpayers have been reduced significantly, leading to reduction in costs of compliance. Taxpayers previously had to endure multiple visits from tax inspectors checking compliance with different taxes. Now a single visit is made to verify all taxes at the same time.
- All operational units now use a single, integrated database, thereby enhancing efficiency.
- An excellent set of monitoring indicators has been developed to track the effectiveness and efficiency of the tax service in the two pilot regions.

52. As a result of the experiences in the pilot regions the MinTax has developed standard organizational structures for Local Tax Inspectorates and is formally shifting to such structures in all the regions of the Russian Federation.

### ***Bank Performance***

53. This PPAR agrees with the ICR rating that the Bank's overall performance, judged by the quality of service that it provide, was satisfactory. The Bank's work in developing the project needs to be placed in context. At the time of the project the Bank did not understand Russian institutions very well, and vice versa. Originally Bank involvement was dependent technically on the IMF which had resident experts working in the STS, and had initiated a small prototype project on new tax processes in one tax office in Moscow on which TAMP was to be based. Within the Bank, project preparation was carried out with IMF experts providing the technical input, and with the human development division providing the resources and guidance. Expertise in information technology was added to the Bank's appraisal team.

54. Project design proved appropriate for the most part. The design sought to build on the local office prototype developed by the IMF/EU by reorganizing tax administration in two full regions with a view to developing and testing procedures and processes for nationwide implementation. The core components were and remain essential for reforms: functional reorganization, development of new tax processes, automation, and staff development. The basics of the project proved to be sound: a phased, pilot approach by which adjustments could be made in project design based on lessons from experience in implementation. But *implementation issues were not adequately anticipated, and many stakeholders were not consulted at design stage*. For example, Information Technology (IT) vendors could have been consulted during the process of preparing the strategy for procurement, and this could have avoided some procurement problems.

55. *The level of risk analysis was inadequate, particularly given the radical changes taking place in the external environment, the unfamiliar borrower, likely unforeseen*

*obstacles to reform*, reluctance to finance TA with loan funds, etc. In retrospect, the Bank and Fund were too optimistic about the time required to implement the far-ranging changes intended under the project. Some of the components were overly ambitious, particularly the range of technical assistance provided for the STS headquarters. STS implementation capacity was over-estimated, as became evident in the slow pace of implementation compared with the original schedule. Moreover, incentives were misjudged, particularly senior management commitment for a project with payoff only in the medium to long term. Relatively few direct incentives were provided to the STS headquarters in the project; the bulk of the assistance being directed at the two regions.

56. The level of institutional analysis of STS headquarters was inadequate, but this was not standard Bank practice at the time. The requirements for institutional development at STS headquarters were not well thought through. In particular, the requirement that STS reorganize itself was, in retrospect, premature and must await the full conversion to a functional organization in the regions. Institutional analysis would have also indicated where to invest in facilitating reform--investing in champions at Headquarters and the pilot regions.

57. The QAG report rated the Bank's quality of supervision as "marginally satisfactory, but improving. The Bank staff had to deal with almost overwhelming odds given the very difficult implementation environment and the project design problems. To its credit, the underlying problems were detected early and remedial actions proposed. When the situation failed to improve, Bank management took the decision with the Borrower to cancel the loan in October 1996. This would have been the first 'punitive' cancellation in the Russia portfolio." (QAG, Annex 6, p. 2) The Bank's firm stand may have played a part in prompting the government to take action in strengthening top management at the STS. The Bank agreed nine months later to resuscitate the project after new management had been appointed to the STS.

58. *The Bank was preoccupied with IT and procurement issues, and the focus on institutional development objectives often suffered.* In reformulating the project, the QAG report expressed disappointment that an opportunity was lost in re-focusing the project on ID issues "A more rigorous assessment of real progress on the ground in June 1997 before the project restart, coupled with a more explicit set of performance conditions, might have reversed the project's inexorable drift from an ID to an IT project." (QAG, Annex 6, p. 2). The Bank's supervision team paid special attention to the warnings in the QAG, but IT remained the main focus. The slow and complex procurement process of the Bank and pressing procurement problems inevitably took too much attention, at the expense of ultimate objectives. The lack of adequate capacity to provide practical procurement assistance by the Bank's local office did not help matters. However, the Bank and the client progressively learned to give more attention to the institutional development aspects.

59. *The all familiar common bias of funding agencies in favor of hardware and procurement matters did reinforce a similar bias in Russia against investing in intangibles such as training and management systems.* Training should have started as early as possible, to engender ownership, facilitate change and balance attention towards investment in people, not just machines. Similarly, *more attention should have been*

*given to software development, prior to any substantial investment of hardware.* As the Ministry proceeds to scale up the program under TAMP II, it will need to build its project management capabilities to ensure integration, sequencing, and balancing among its businesses, systems, and processes.

60. This PPAR rates Bank supervision performance satisfactory, as the team provided “hands on” advice, flexibility and willingness to adapt the pilot to new facts on the ground. The Bank diligently supervised the project, generally carrying out field supervision at least twice a year except for 1996 and 1997. The Bank’s budget for supervision did not allow for unscheduled travel to meet the new Ministers in the STS. Given the frequent replacement of ministers, this could have been useful. The Bank identified and raised implementation problems quickly. It took a proactive approach to close the project when problems became intractable. Improvement in implementation took place after, and most likely in response to, the Bank’s strong stand on project cancellation. The Bank also conducted a review of project quality at entry in 1997/8. The Bank showed flexibility at project re-start in 1997 to correct most of the design problems, to introduce new components and to reformulate others. In the end these efforts paid off. The tax authorities were highly satisfied with the overseas and local training received, and – in fact – atypically requested reallocation from the equipment category to training at the end of the project.

61. Many factors contributed to project turnaround: the renewed commitment and efforts of the Russian tax authorities after 1997, the competence and ownership of the regions involved, the high quality advice provided by the IMF and additional assistance agreed with USAID/US Treasury. Long-term advisors who understood both the Bank and Russian realities were also critical to bridge the gap between Bank requirements and local understanding. But the continuity and determination of the Bank’s task manager also contributed to the positive results obtained. Openness to ideas from other sources of assistance such as US Treasury also helped. The Bank supervision team received an award for quality of supervision in FY 2001.

### ***Borrower Performance***

62. The assessment agrees with the ICR in rating borrower performance satisfactory. Its highly satisfactory performance in the final two and a half years of implementation compensates for the highly unsatisfactory performance in initial implementation. Regional performance was fully satisfactory throughout the project.

63. The loan request submitted by the STS to the Bank and IMF was thorough and competently prepared. But most of the preparation work was done by outside experts with endorsement by the STS. The Borrower and STS management did not fully understand or “own” the project at the design stage. Nor did they fully comprehend the ramifications of the reforms proposed. Outsiders essentially prepared the program. To be fair, neither did the Bank fully appreciate the challenges of implementation of such reforms.

64. In retrospect, elimination of the Moscow region as one of the project’s pilots, a decision made by government late in project development, was unfortunate. It was made

to minimize the risks since the Moscow region accounts for about 35% of national tax revenues. This reduced substantially the possibility of close observation of results that could have helped motivate STS management on implementation. However, this deficiency was later addressed and the Moscow region was re-instated during project reformulation in 1997.

65. The government can be faulted for allowing the project to founder for so long without solving its problems -- such as management indifference and chronic shortage of funds. Ministry of Finance officials were preoccupied with other pressing matters, such as raising immediate revenues. In addition, the Ministry of Finance never addressed systematically the problem of counterpart funding shortages.

66. The performance of the STS, and its successor the MinTax, were quite different during the life of the project. Performance by the central authorities was clearly unsatisfactory between 1995 and 1997. Top management largely ignored the project and did not assign the project sufficient priority to solve its lack of counterpart funds. However, from project "re-start" in 1997 to its conclusion in 2000, performance of the implementing agency was stellar. The Deputy Minister in charge of modernization brought in consultants from the private sector, re-assigned the software development from the Federal GNIVTS to that in Nizhny Novgorod, and upgraded the staff of the Project Coordinating Unit. The implementation moved relatively smoothly thereafter to its highly successful conclusion.

67. There was a noticeable difference between the degree of involvement at the regional and the central level. In contrast with headquarters, commitment was always strong in the two regions that received the bulk of the project assistance. Competence and ownership of the project were uniformly high at the provincial level. The regions had a greater understanding of the concrete problems at hand and requirements for system development. Lack of staff with field operational experience at headquarters was one of the weaknesses of the central project management, and of the STS bureaucracy more generally.

68. The performance of the implementing agency was not fully adequate in one area: quarterly reporting and use of monitoring and evaluation indicators. Progress reports were not forthcoming from the implementing agency until very late in the project. The final report of the implementing agency, however, is exemplary and includes voluminous data about performance of various aspects of the project. The use of monitoring and evaluation should be regularized in any future project from the start.

## **Lessons Learned**

69. Conclusions and lessons are:

- **Ownership can be built from the bottom up. It can be engendered by demonstrating change from the bottom up, using regional pilots and judicious sponsorship from the top.** Large-scale top-down institutional reforms may not be an option from the outset, particularly for large countries with diverse regions, when headquarters are distant from client services and

local problems, and when there are strong vested interests in the status quo and fear of change. The project suffered neglect at the Headquarter of the Ministry soon after approval, but the pilot regions maintained ownership and commitment and demonstrated improvements at the front line. Ironically, a weak central project management unit at the start may have allowed the regions to develop their own solutions without undue interference. The regions were at the frontiers, faced with excessive workload and unsatisfied customers, thus perhaps more prepared for change. Then, a reform-minded leadership did help turn around the project on measures that were necessary to come from the center. But as the pilots are now expected to be scaled up, it will become more important to broaden such ownership beyond the new regions to be covered, to include both headquarters and the general public. The project also demonstrated that blueprint conditionality and the financing of a large volume of TA and studies cannot substitute for ownership. Russia must be seen to drive the change. Local change agents should be exposed to outside perspectives and alternative models. Piloting change and engendering local ownership through training, experience demonstration, study tours and support to champions are essential.

- **Piloting is judicious when there is a need for integrating comprehensive and complementary reforms on a scale where complexity and risks are manageable and early results are necessary.** In this case, it was critical to carry out several complementary reforms that cover functional reorganization, process changes, mission-oriented training, and substantial computerization. Carrying out these complementary activities is necessary to realize the benefits from investments in computerization. But doing so on a large scale from the start would have involved unmanageable complexity and risks, and this could have ended with a major failure. Piloting presents a dilemma since it still requires the commitment of stakeholders at all levels, even while keeping project scope and implementation focused on the pilot area or constituency. However, piloting could be an effective instrument if it is designed for learning from the start, that is, to test explicit hypotheses and strategies and to identify risks and tradeoffs. Scaling up remains a challenge, but now a road map has been established, skills built, mindset changed, and hopefully, the core project management systems sufficiently developed.
- **Pacing change and maintaining flexibility are critical to major organizational change.** A pilot implies a lack of a blueprint, of consensus on means, and of certainty about the feasibility and pace of change. Therefore it would be misleading to prematurely judge early performance or to consider the deviations that are likely to arise from learning and adaptation as failures. In this case, the project was about to be cancelled in midcourse. Bank staff continuity, flexibility, persistence, pro-activeness, and their partnership with reform-minded local counterparts were critical to adapt and reshape the project. Critical to such flexibility is the availability of adequate resources for supervision and knowledge transfer. The pilot was prepared in record time in response to an urgent need, so risk taking was inevitable. It also set ambitious

targets, in line with client aspirations. But time to develop software, build management systems and change organizational behavior is often underestimated. The project has stretched client capacity. But Bank and client staff persisted with the project, with the objectives rather than a blueprint, and TAMPI ultimately exceeded Bank expectations. An important byproduct of this flexible yet persistent approach is that the client organization learned how to learn and now accepts change as a continuous process.

- **Strategic management, including sequencing of hardware and software and organizational change are important in introducing comprehensive organizational development and large-scale computerization.** It takes strategy, time and sequencing to develop new management systems and practices. But to the extent project progress is measured by disbursements, the all too common bias to proceed with hardware ahead of less costly and more difficult investments in intangibles will continue. Expertise in organizational change, management systems, and human resource development will be even more essential to the scaled up program. These managerial capabilities must be embedded within the Ministry, not just the PIU. The Ministry is cognizant of this lesson and for the second project it created a Modernization Department, well staffed and technically capable. This modernization department will carry out modernization of all regions, not only the ones under the project, thus ensuring that the government would realize the benefits on a larger scale than the Bank's financed program.
- **Bank procurement procedures should be adapted to deal with the relatively unpredictable but critical process of customized software development.** Tax systems often require more customized and complex software than other government applications. Customization also entails more concerted efforts to ensure system sustainability and IT staff support. In this case, the Bank did not adequately evaluate the technical soundness of the prototype that was developed with IMF/EU, despite the criticality of this application software. As a result of delays in such software development, the hardware was procured earlier, and had to be upgraded to match the new demands. Thus the pilot indicates the need for better protocols to further adapt and deploy the tax software in the follow up program. Moreover, Bank procurement procedures prevented the Bank from financing software development because it was carried out by a specialized company that serves the Ministry--not an unusual practice that enable governments to recruit and retain highly specialized skills and adapt such capabilities to government's special business requirements. Under Bank rules, such companies are also barred from competing with private companies if and when the government opts for outsourcing such services through competitive bidding. Also, because of the confidential nature of the software algorithms, Russia could not accept open bidding for the software development effort. The Bank's team could not reconcile Russia's concerns (and the criticality of software development to project success) with the Bank's procurement requirements, which proved to be rigid. It is therefore recommended that the Bank reviews its software

procurement procedures to meet both the objectives of efficiency and responsiveness to clients' concern with confidentiality and emerging specialized expertise.

- **Social marketing and image building are important activities to facilitate change in client behavior and to scale up institutional reform efforts.** Political will and public support must be nurtured. This is critical to overcoming the massive bureaucratic resistance to change as similar modernization is extended to other regions rather rapidly and as the support systems at headquarters will have to change accordingly. During implementation, the Ministry grew increasingly convinced that taxpayer education and mass communication are good investments, and essential to enhance compliance and institute self-reporting by taxpayers. Such activities will need to be further developed, scaled up and sustained under TAMP II. Similarly, the Bank and the Ministry need devote more attention to publicize the success of the pilot, and the lessons learned. Attention to external relations is particularly critical in Russia to improve the Bank's image and to encourage further modernization of public sector institutions under the eRussia program.
- **E-government programs should build on local experience with pilot computerization and organizational change, and on and the technical platforms and standards already established.** The experience of TAMPI indicates that line management ownership at the ministerial and local levels is critical to government-wide modernization. It also point to the competencies, technical and managerial, that will be critical to implementing eRussia, a high priority national program to use information and communication technologies to improve governance, modernize public services and enhance the competitiveness of the whole economy. To realize the benefits of computerization, substantial efforts are needed to change mindsets and ways of doing business. Exposures to homegrown success and international best practice are needed. It would be costly for each ministry to reinvent this experience. The project also points to opportunities to adopt common standards and databases, and to build a common communication infrastructure across ministries. In doing so, lead roles and responsibilities for key ministries will need to be defined. Since modernization of many strategic systems will be necessary (and given the current low levels of computerization in Russia), and these systems and platforms cut across ministries, it is the right time for the Bank and government to worry about these issues. For example, a unified national registration (or personal identification) system needs to be adopted by all ministries and levels of governments. The MinTax has successfully developed such a system, so it should not be re-invented by other ministries. Even more important, a unified system would enable all ministries to share data, and would help further cross-checking of all types of information for consistency, reliability, transparency, and anti-corruption.

## Annex A. Basic Data

### TAX ADMINISTRATION MODERNIZATION PROJECT (LOAN 3853)

#### Staff Inputs (staff weeks)

	No Staff Weeks	US\$ ('000)
Identification/Preparation	17.3	65.8
Appraisal/Negotiation	11.1	25.4
Supervision	167.8	580.4
ICR	2.2	31.6
Total	198.4	703.2

#### Mission Data

	Date (month/year)	No. of persons	Specializations represented	Performance rating	
				Implementation Progress	Development Objective
Identification/ Preparation	08/23/1994- 08/31/1994	7	Task Mgr, Country Economist, Sr. Automation Specialist, Russian Implemen. Expert, Operations Analyst, Procurement Specialist , Tax Admin Exp (IMF)		
Appraisal/Negotiation	11/14/1994- 11/22/1994	6	Task Manager, Sr. Automation Specialist, Russian Implem. Expert, Implementation Specialist (2) Tax Admin. Expert (IMF)		
Supervision	3/13/1995- 3/23/1995	6	Task Manager, Sr. Automation Specialist, Procurement Specialist, Human Resource Expert, Tax Admin Expert (IMF), Staff Assistant	S	S
Supervision	6/26/1995- 6/30/1995	2	Sr. Automation Specialist, Human Resource Expert	U	S
Supervision	12/05/1995- 12/14/1995	3	Task Manager, Sr. Automation Specialist, Human Resource Expert	U	U
Supervision	3/26/1996- 4/5/1996	2	Sr. Automation Specialist, Human Resource Expert	U	U
Supervision	6/13/1997- 6/23/1997	6	Task Manager and Senior Automation Specialist, Tax Admin. Expert (Bank), (2) Tax Admin. Expert (IMF), Operations Analyst, Human Resource Expect	S	S
Supervision	01/19/1998- 01/30/1998	6	Task Manager and Senior Automation Specialist, Tax Admin. Expert (Bank), Country Economist, Tax Admin Expert (IMF), Operations Analyst, Research Assistant (IMF)	S	S
Supervision	Mid-Term Review 10/26/1998- 11/4/1998	7	Task Manager and Sr. Automation Specialist, Lead Specialist and Advisor, Country Economist Tax Admin Expert (Bank), Operations Analysts, Staff Assistant	U	S
Supervision	6/17/1999	2	Task Manager and Sr. Automation Specialist, Country Economist	S	S
Supervision	11/01/1999- 11/11/1999	6	Task Manager and Senior Automation Specialist, Lead Specialist and Advisor, Tax Admin Expert (Bank), Country Economist, Operations Analyst, Staff Assistant	S	S
Supervision	6/5/2000- 6/9/2000	3	Task Manager and Senior Automation Specialist, Country Economist, Operations Analyst	S	S
Supervision	11/6/2000- 11/10/2000	6	Task Manager and Sr. Automation Specialist, Lead Specialist and Advisor, Country Economist, Tax Admin Expert (Bank), Operations Analysts, Staff Assistant	S	S
Completion	TBD				



Helen Phillip  
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