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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED DEVELOPMENT POLICY CREDIT

IN THE AMOUNT OF SDR 25.1 MILLION (US$35MILLION EQUIVALENT)

AND A PROPOSED DEVELOPMENT POLICY GRANT

IN THE AMOUNT OF SDR 25.1 MILLION (US$35 MILLION EQUIVALENT)

TO

THE REPUBLIC OF MOZAMBIQUE

FOR AN

ELEVENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING

November 23, 2015

Macroeconomics and Fiscal Management Global Practice
Africa Region

MOZAMBIQUE - GOVERNMENT FISCAL YEAR
January, 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of 31 October 2015)

Currency Unit	=	New metical (MZN)
US$1	=	MZM 42.01
MZM1	=	US$ 0.0238
US$1	=	SDR 0.7159

WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS AND ACRONYMS

BdM	Central Bank of Mozambique (*Banco de Moçambique*)
CCSPP	*Comité de Coordenação e Selecção de Projectos Públicos* (Committee on Coordination and Public Project Selection)
CGDP	*Comité de Gestão da Dívida Pública (*Committee on Public Debt Management)
CGE	*Conta Geral do Estado* (General State Accounts)
CPS	Country Partnership Strategy
CUT	*Conta Única do Tesouro (*Treasury Single Account)
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
e-BAU	*Balcão de Atendimento Unico Electrónico* (Integrated IT platform automating business registration)
EITI	Extractive Industries Transparency Initiative
EMATUM	*Empresa Moçambicana de Atum (Mozambican Tuna Company)*
ENSSB	*Estratégia Nacional de Segurança Básica* (National Strategy on Basic Safety Nets)
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Product
GoM	Government of Mozambique
HDI	Human Development Index
ICA	Investment Climate Assessment
IDA	International Development Association
IFC	International Finance Corporation
IGF	General Inspectorate of Finance (*Inspecção Geral de Finanças*)
IMF	International Monetary Fund
INAS	National Institute of Social Action (*Instituto Nacional de Acção Social*)
INE	National Statistical Institute (*Instituto Nacional de Estatística*)
LNG	Liquefied Natural Gas
MAGTAP	Mining and Gas Technical Assistance Project

MDM	*Movimento Democrático de Moçambique* (Democratic Movement of Mozambique)
MEF	Ministry of Economy and Finance
MICOA	*Ministério para a Coordenação de Acção Ambiental* (Ministry for Coordination of Environmental Action)
MoF	Ministry of Finance (*Ministério das Finanças*)
MoU	Memorandum of Understanding
MOZAL	Mozambique Aluminum Company
MPD	Ministry of Planning and Development (*Ministério do Planificação e Desenvolvimento)*
MSME	Micro, Small and Medium Enterprises
NCB	Non-Concessional Borrowing
OCI	Internal Control Units (*Órgãos de Control Interno*)
OE	*Orçamento do Estado (*State Budget)
PAF	Performance Assessment Framework
PARP	Action Plan for the Reduction of Poverty (*Programa de Acção para a Redução da Pobreza*)
PASD	Direct Social Action Program (*Programa de Apoio Social Directo*)
PASP	Productive Social Action Program (*Programa de Acção Social Productiva)*
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PES	Economic and Social Plan (*Plano Económico e Social*)
PFM	Public Financial Management
PII	*Plano Integrado de Investimento* (Integrated Investment Plan)
PIM	Public Investment Management
PQG	*Plano Quinquenal do Governo* (Government Five-Year Plan)
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
PSSB	Basic Social Subsidy Program (*Programa de Subsidio Social Básico)*
SDR	Special Drawing Rights
SOE	State Owned Enterprises
SPP	Social Protection Project
SRB	Single Registry of Beneficiaries
SSA	Sub-Saharan Africa
UN	United Nations
VAT	Value-Added Tax

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REPUBLIC OF MOZAMBIQUE

ELEVENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING

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SUMMARY OF PROPOSED CREDIT AND GRANT

THE REPUBLIC OF MOZAMBIQUE

ELEVENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING

Borrower	The Republic of Mozambique
Implementing Agency	Ministry of Economy and Finance
Financing data	50 percent IDA Credit and 50 percent IDA Grant. Currency is US$. Amount: SDR 50.2 million (US$70 million equivalent). The Credit will be on IDA terms, and will have a final maturity of 38 years, inclusive of 6 years of grace period.
Operation type	Programmatic, the third in a series of three annual single-tranche operations with funds to be disbursed from the Credit and the Grant (the Financing) upon effectiveness.
Pillars of the Operation and PDOs	The objective of the PRSC series is to assist the Republic of Mozambique to: (i) improve business climate and to increase transparency in the management of extractive industries; (ii) strengthen social protection; and (iii) enhance public finance management.
Result Indicators	*Policy Area (i): Improve the business regulations and investment climate and increase transparency in management of extractive industries* *1.* Number of days needed to obtain a business license. *Baseline*: Commercial 15, Industrial 40; *Target*: Commercial 8, Industrial 20. *2.* Number of days needed to start a business: *Baseline*: 13; *Target* 8. *3.* Number of applied EITI principles and criteria. *Baseline*: No compliance. *Target*: Mozambique remains EITI compliant and publishes reconciliation reports up to 2014 in line with new guidelines. *4.* All new mining and petroleum contracts starting 2015 will be negotiated under the revised legislative framework. Baseline: None; Target: All *5.* Percentage of transfers to communities that are executed. *Baseline*: 0%; *Target*: 80%. *Policy Area (ii): Strengthen Social Protection* *6.* Share of the benefits of PASP transfers to those above the US$1.25 poverty line. *Baseline*: 10%. *Target*: 2%. *7.* Total number of direct public works program (PASP) beneficiaries. *Baseline*: 0; *Target* 20,000 direct beneficiaries from the PASP. *8.* Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due. *Baseline*: 0; *Target*: 50%. *Policy Area (iii): Enhance Public Finance Management* *9.* Percentage of recommendations implemented by the entities audited/inspected by the OCI's and IGF. *Baseline*: Less than 15%; *Target*: To at least 40%. *10.* Percent of public investment projects that has been developed, appraised and evaluated, following the guidelines adopted for project appraisal and evaluation. *Baseline*: 0. *Target*: All public investment projects in the Integrated Investment Program, including an analysis of returns to investment. *11.* Quarterly and yearly debt reports published. *Baseline*: Debt reports only published on an annual basis. *Target*: Quarterly debt reports are prepared for the 2013 and 2014 fiscal years and published. The Government broadly adheres to the annual domestic borrowing plans issued. *12.* Fiscal risks statement in the budget. *Baseline*: No information on fiscal risks in budget documentation. Target: Detailed information and quantification on fiscal risks included in the 2017 budget.
Overall risk rating	Moderate
Climate and disaster risks	Mozambique is moderately at risk from natural disasters and weather-related risks. The floods in early 2015 are a reminder that Mozambique is one of the countries in SSA most exposed to droughts, floods and cyclones. Responding to disasters can draw scarce administrative and financial resources away from the reform program and threaten its long-term continuity. The risk of major disruptions to the reform program is mitigated by the Government's commitment to rapidly implementing many key policies supported by the proposed PRSC. The Climate Change DPO series is supporting a dialogue on enhancing resilience to natural disasters.
Project ID	P154422

INTERNATIONAL DEVELOPMENT ASSOCIATION
PROGRAM DOCUMENT
FOR A PROPOSED ELEVENTH POVERTY REDUCTION SUPPORT
DEVELOPMENT POLICY FINANCING (PRSC)
TO THE REPUBLIC OF MOZAMBIQUE

1. INTRODUCTION AND COUNTRY CONTEXT (INCLUDING POVERTY DEVELOPMENTS)

1. **The Eleventh Poverty Reduction Support Development Policy Financing (PRSC-11) to the Republic of Mozambique is fully aligned with the priorities of the Government's new 5-year plan (*Plano Quinquenal do Governo – PQG*)** and is an integral part of the Bank's strategy to support the Government's PQG. The proposed operation is the third and final of three annual single-tranche operations to be delivered over FY13-16. This program document proposes a set of prior actions for the PRSC-11 and presents the results framework for the programmatic series.

2. **This programmatic series is designed to improve the country's business climate and increase transparency in the management of natural resources, strengthen social protection and enhance public finance management.** The series supports reforms in key policy areas, including: (a) improving the business climate and increasing transparency in the management of extractive industries, by simplifying business regulations for promoting broad-based growth and enhancing the legal and institutional framework for the resource sector, (b) strengthening social protection, by reducing economic vulnerability through well-targeted social-protection policies, and (c) enhancing public finance management, by improving the management of public investments, debt and fiscal risks.

3. **Mozambique's economy has grown rapidly since the end of the civil war in 1992.** Annual Gross Domestic Product (GDP) growth averaged around 8 percent over the past two decades. Robust growth was made possible by sound macroeconomic management, a number of large-scale foreign-investment projects, political stability and significant donor support[1]. However, there has been relatively little structural transformation in the economy (Table 1). The share of manufacturing in the economy, which grew from 13 percent in the early 1990s to 16 percent in the early 2000s, had fallen to 10 percent in 2010-14. The share of the agricultural sector, which initially fell from 35 percent before the end of the war to 24 percent in the early 2000s, has increased again to 27 percent recently. In recent years, strong growth has been supported by Foreign Direct Investment (FDI) inflows in extractive industries. Major discoveries of coal and gas may transform Mozambique into a significant player in global energy markets and the country's medium term reform agenda needs to focus on strengthening Government capacity to better manage the country's extractive industries.

[1] World Bank, 2012, "Mozambique - Reshaping Growth and Creating Jobs through Trade and Regional Integration - Country Economic Memorandum", Report No. 59356-MZ.

Table 1: Structure of Mozambique's Economy, 1990-2014

	1990-94	*1995-99*	*2000-04*	*2005-09*	*2010-14*
Agriculture	35.1%	32.1%	24.4%	27.6%	27.5%
Manufacturing	13.1%	14.0%	16.4%	14.4%	10.4%
Other Industry	3.6%	4.4%	5.6%	6.3%	9.1%
Services	48.2%	49.5%	53.6%	51.7%	53.1%

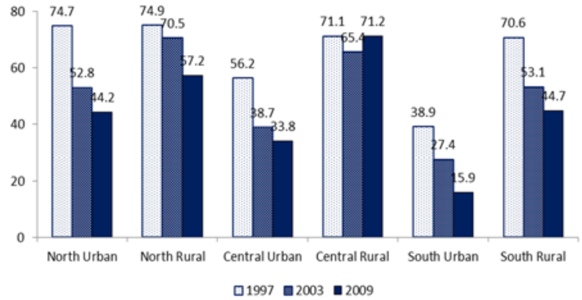
Source: INE

4. **Over the past decade, rapid growth has not translated into significant poverty reduction.** Strong economic growth led to a decline in the national poverty headcount by 14 percentage points between 1997 and 2003 to 56 percent, implying a growth elasticity of poverty reduction of 0.3. Poverty fell between 2003 and 2009 to 52 percent, implying a growth elasticity of poverty reduction of only 0.14. The weakened relationship between growth and poverty reduction is, as argued in the forthcoming Systematic Country Diagnostic for Mozambique, a result of the changing pattern of growth. In the immediate aftermath of the war, growth was led by the resumption of economic activities, particularly in agriculture, while in the past decade, it was driven by investments in capital-intensive, import-dependent sectors. This pattern of growth is also reflected in labor markets, which continue to be dominated by low skilled labor in the agricultural sector; meanwhile, the rest of the economy is unable to offer better-remunerated jobs for the 300,000 new workers entering the labor force every year. It is worth highlighting that the last household survey was conducted in 2008/09. Any assessment on poverty or the inclusiveness of growth is therefore using dated information, particularly for a country growing so rapidly. The Government, supported by the World Bank, has recently finalized data collection for a new household survey. As the information of this household survey becomes available in 2016, there will be a need to reassess the relationship between growth and poverty in Mozambique.

5. **The geographical distribution of poverty remains largely unchanged, with poverty concentrated in rural areas and in the Central and Northern regions.** The moderate reduction in poverty observed in the mid- and late-2000s was led by declining poverty rates in the less poor Southern region and in urban centers. Rural poverty continues to be severe and pervasive. Poverty fell in rural areas in the South, reflecting spillover effects from the rapid growth of urban centers in the region. In Central Mozambique, the poverty headcount increased between 2003 and 2009. The forthcoming Systematic Country Diagnostic for Mozambique argues that the decline in the responsiveness of poverty reduction to growth seems to be driven to a large extent by poverty trends in Nampula and Zambezia, with poverty rates increasing in these two provinces while they declined in the rest of the country. Poverty has declined in the rest of Mozambique at a faster rate than in the rest of Sub-Saharan Africa, with a growth-elasticity of poverty reduction of -1.18 compared to -0.7 for Sub-Saharan Africa on average. The Government's official poverty statistics present a different picture, due to methodological differences[2].

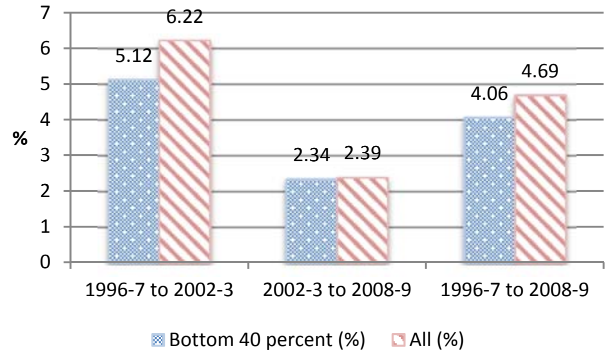
[2] See "Poverty in Mozambique: New Evidence from Recent Household Surveys" (World Bank 2012) for a discussion on those methodological differences. Official statistics place the poverty rate in both 2003 and 2009 at about 54 percent and the distribution of poverty also differs, with poverty lowest in the rural north and Maputo city, while poverty is highest in the south of the country.

Figure 1: Poverty Headcount Rates by Region and Location



Source: "Poverty in Mozambique: New Evidence from Recent Household Surveys" (World Bank 2012).

Figure 2: Annual Average Growth Rate of Per Capita Consumption



Source: IOF (Inquéritos dos Orçamentos Familiares) and World Bank Staff Estimates

6. **The bottom 40 percent of the population have so far benefited less from growth than the overall population.** Between 1996-97 and 2008-09 average consumption of the bottom 40 percent of the population grew by 4.0 percent per year, while that of the total population grew by 4.7 percent per year. A comparison of the growth in consumption of the bottom 40 percent with other low income countries shows that Mozambique is on par with many peers, but the trends in Mozambique could be very different given the very high growth rates observed in the past. The GINI index, although declining between 2003 and 2009, remains relatively high at 45.7, which puts Mozambique at the upper end of the distribution when compared to its peers in Sub-Saharan Africa. A pattern of growth driven by extractive industries with limited linkages to the rest of the economy may contribute to a concentration of returns on growth at the upper end of the income distribution, highlighting the need to renew efforts to achieve a more inclusive growth pattern.

7. **In addition to pervasive monetary poverty, Mozambique faces enormous challenges in improving social indicators.** In 2014, Mozambique's per capita income was US$586, about one-third of the Sub-Saharan Africa (SSA) average. Mozambique ranked 178th out of 187 countries in the Human Development Index in 2014. The adult literacy rate is 56 percent, and average life expectancy at birth is just 50 years. Malnutrition significantly worsened between the mid-1990s and 2003 and it took almost a decade for malnutrition to return to the mid-1990s levels. Malaria remains the most common cause of death, responsible for 35 percent of child mortality. Limited progress has been achieved in improving water and sanitation. Nevertheless, Mozambique has made important progress in some areas. School enrollment rates—and gender parity in enrollment—have increased dramatically over the past decade, while infant and maternal mortality rates have consistently declined.

8. **Despite significant development challenges, Mozambique has made tremendous progress since the end of the civil war in 1992**. After a civil war that completely destroyed the country's infrastructure and institutional and social fabric, Mozambique experienced a period of strong growth and rapid poverty alleviation, combined with rapid improvements in development outcomes, facilitated by a return to normality after the civil war and strong donor engagement. Since the early to mid-2000s, progress seems to have slowed down, with limited poverty reduction, increased inequality and limited structural transformation. The emergence of natural resources and associated economic rents has exacerbated governance challenges. But the growth of the extractive industries

is also a sign of the tremendous progress that Mozambique has made as a country, being able to attract multi-billion investments to develop its natural resources and a growing and more confident public sector that is being able to steer this process. Mozambique is a story of state building, institutional strengthening and steady improvement in public services delivery from an extremely low base.

9. **Support by development partners, including budget support, has contributed to achieving this steady progress in state building, institutional strengthening and improved services delivery.** An evaluation of the first 10 years of budget support (1994-2004)[3] found that budget support had strengthened Government systems and leadership at a time when these were extremely low. Budget support also contributed to increasing pro-poor public spending, increased public spending efficiency, stronger domestic accountability systems, and it had a positive effect on service delivery and responsiveness. A more recent evaluation of budget support in Mozambique[4], analyzing the impact of budget support from 2005 to 2012 on development outcomes, suggests that budget support has been successful in achieving its objectives. Budget support has contributed to continuous institutional strengthening on Public Financial Management (PFM) and in key Government agencies such as the Revenue Authority, General Inspectorate of Finance and the Supreme Audit Institution. Budget support has also supported policy dialogue on difficult areas such as governance, while strengthening domestic accountability systems. Budget support allowed the Government to increase the allocation of public resources to development priorities while maintaining fiscal and macroeconomic stability. While budget support in general, and the PRSC program in particular, have contributed to this progress, going forward, it will be important to be more selective in the support being provided and to focus it on addressing key bottlenecks that are constraining a more inclusive growth process.

10. **This PRSC series is an important component of the Country Partnership Strategy (CPS) discussed by the Board in April 2012 and it supports the World Bank's twin goals of ending extreme poverty and promoting shared prosperity.** Under the FY12-15 CPS (Report No. 66813-MZ) the Bank is committed to aligning its support with the national budget process. The indicative lending scenario of the CPS envisages consecutive PRSCs as one of the instruments to support the Government's poverty reduction agenda. The World Bank is also supporting other reforms that contribute to a more inclusive growth process through sectoral budget support operations in agriculture, climate change and financial sector development. These budget support operations are elements of a wider World Bank program, in support of Mozambique's development priorities. The reforms supported by the PRSC series are contributing to a more inclusive growth pattern. The introduction of the *Balcão de Atendimento Unico Electrónico* (e-BAU) supports private sector growth and employment creation as improved business environment helps raise productivity. By revising the legislative and regulatory framework in the mining and hydrocarbons sector, the Government is capturing a larger share of the rents to support its poverty reduction agenda. A revised system to transfer mining and petroleum royalties to producing communities will ensure that these communities also benefit from the country's natural resources. Reforms to the implementation of

[3] DAC Network on Development Evaluation (OECD), 2006, "Evaluation of General Budget Support – Mozambique Country Report", A Joint Evaluation of General Budget Support 1994-2004

[4] European Union, MPD and other partners, 2014, "Independent Evaluation of Budget Support in Mozambique. Final Report Volume I", Evaluation jointly managed by the European Commission, MPD, and the evaluation departments of Ireland, Germany, Belgium, Italy, Finland, the Netherlands and France

social protection programs will enhance their effectiveness and ultimately their impact on the poor and vulnerable.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

11. **Growth in 2014 reached 7.2 percent, in line with projections.** Agriculture accounts for about 26 percent of GDP and employs 78 percent of the labor force. Growth has been broad-based across economic sectors. The main contributors to GDP growth in 2014 were financial services, agriculture and trade. Extractive industries has been the most dynamic sector in the economy for the past few years but its contribution to growth remains limited given its relatively small share in the economy. Growth in extractive industries has decelerated compared to previous years, given low commodity prices and infrastructure constraints. Mozambique adopted in 2014 a new base year (2009) for the compilation of national accounts, taking into account new available data sources and new sectors of economic activity. The revised GDP figures are slightly higher than previous GDP figures (4 percent higher in 2012). Growth in the first half of 2015 decelerated to 6.3 percent from 6.9 percent in the first half of 2014. The most dynamic sectors in the second quarter of 2015 were extractive industries, construction, fisheries and electricity, gas and water.

Figure 3: Sectoral Contribution to GDP Growth

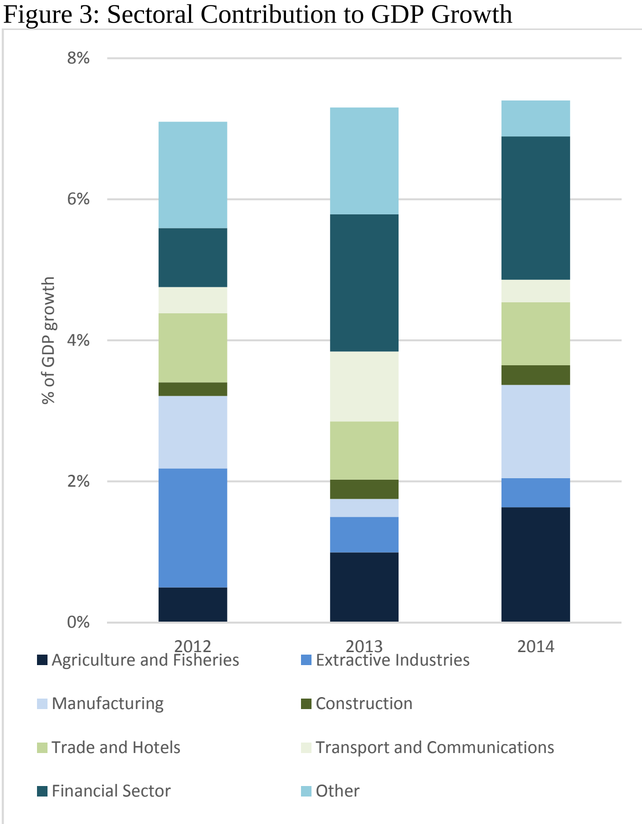
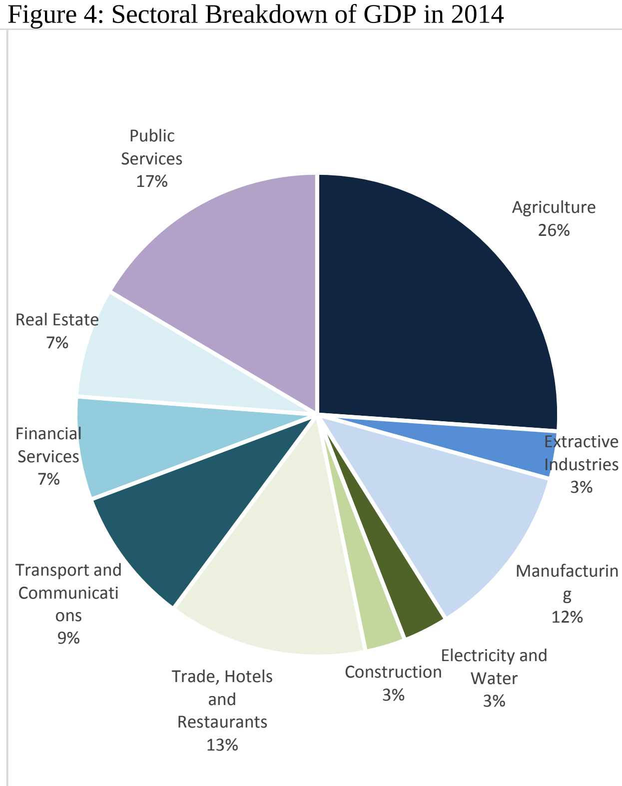


Figure 4: Sectoral Breakdown of GDP in 2014



Source: INE and World Bank staff calculations.

Table 2: Key Macroeconomic Indicators, 2012-2017

	2012 Act.	2013 Act.	2014 Act.	2015 Proj.	2016 Proj.	2017 Proj.
GDP (nominal – billion meticais)	433	482	536	598	673	762
Consumption (% of GDP)	92.9	92.8	94.1	93.2	92.2	90.9
Investment (% of GDP)	17.3	17.6	14.9	15.7	16.8	18.1
Net exports (% of GDP)	-10.2	-10.4	-9.0	-9.0	-9.0	-8.9
Real GDP growth rate (%)	7.2	7.1	7.2	6.3	6.5	7.2
CPI inflation (%, annual average)	2.1	4.2	2.3	1.9	5.6	5.6
CPI inflation (end of period)	2.2	3.0	1.1	5.1	5.6	5.6
Base money (% change)	19.7	15.7	20.5	22.6	12.0	15.1
Credit to the economy (% change)	19.9	28.7	28.4	19.8	12.3	15.3
Policy lending rate (end of period)	9.50	8.25	7.50	--	--	
Gross domestic savings, exc. grants (% of GDP)	-0.9	12.5	9.5	-1.1	4.6	8.2
Gross domestic investment (% of GDP)	47.4	54.5	46.9	32.1	40.6	65.8
Government	12.7	14.8	18.0	14.0	13.9	14.2
Other sectors	34.7	39.6	28.9	18.1	26.7	51.6
Total Government revenues (% of GDP)	21.9	26.3	27.3	25.2	26.2	26.7
Total Government expenditure (% of GDP)	30.7	34.0	42.2	35.3	33.9	33.8
Overall balance (after grants) (% of GDP)	-3.9	-2.7	-10.6	-6.0	-4.0	-4.3
Terms of trade (% change)	-5.7	-0.7	-1.7	0.0	0.7	-1.6
Current account balance, incl. grants (% of GDP)	-44.7	-39.1	-34.1	-30.2	-33.1	-55.4
Real exchange rate change (% change)	7.1	-1.2	-1.4	--	--	

Source: GoM, BdM, IMF and World Bank estimates and projections.

12. **The Government started efforts to tighten fiscal policy in 2015.** Fiscal policy has been expansionary over the past few years, with public expenditure expanding from 31 percent of GDP in 2012 to an estimated 42 percent of GDP in 2014. This has been partly facilitated by rapid growth in tax revenues, which have grown from below 19 percent of GDP in 2012 to over 23 percent in 2014, reflecting efforts to improve tax administration and capital gains taxes from the extractive industries. Without capital gains taxes, tax revenues have increased by 1 percentage point per year over the past few years. This increase in revenue compensated for a decline in aid flows, which in 2014 financed 18 percent of expenditures (down from 44 percent in 2009). The new Government is committed to a prudent fiscal stance as reflected in the 2015 budget, with expenditure projected to decline by almost 7 percentage points of GDP and the deficit projected to narrow by 4.6 percentage points of GDP. Both current expenditures (particularly goods and services) as well as capital expenditures will decline. The wage bill will decline slightly, from 11.2 percent of GDP to 10.8 percent of GDP and is expected to further decline to 10.4 percent of GDP by 2017. This more prudent fiscal stance will be crucial as Mozambique continues to prepare for managing a much larger resource envelope when resource revenues start to flow.

Table 3: Fiscal Framework, 2012-2017

	2012 Act.	2013 Act.	2014 Act.	2015 Proj.	2016 Proj.	2017 Proj.
	(% of GDP)					
Total revenues	21.9	26.3	27.3	25.2	26.2	26.7
Tax revenue	18.7	22.3	23.4	21.5	22.5	22.9
Income and profits	8.5	11.6	11.4	9.1	10.2	10.5
Taxes on goods and services	7.7	7.9	9.0	9.3	9.4	9.5
International trade	1.8	2.1	2.1	2.0	2.0	2.1
Other	0.7	0.7	0.8	1.1	0.9	0.8
Nontax revenue	3.2	3.9	4.0	3.7	3.7	3.7
Grants received	5.1	5.2	4.2	4.0	3.7	2.8
Total expenditures and net lending	30.7	34.0	42.2	35.3	33.9	33.8
Current expenditures	18.1	19.2	23.8	21.3	20.0	19.6
Compensation to employees	9.6	10.3	11.2	10.8	10.6	10.4
Goods and services	3.5	4.2	7.7	4.3	4.4	4.2
Interest payments	1.0	0.8	1.0	1.4	1.9	1.8
Transfers	4.0	3.9	3.9	4.8	3.2	3.2
Capital expenditures	11.6	12.8	15.0	13.1	12.7	11.7
Externally financed	5.9	5.8	6.8	7.1	6.3	5.5
Domestically financed	5.7	7.0	8.2	6.0	6.4	6.2
Net lending	1.0	2.1	3.0	0.9	1.2	2.5
Externally financed	1.1	2.1	3.0	0.9	1.1	2.5
Domestically financed	-0.1	-0.1	0.1	0.1	0.1	0.1
Domestic primary balance (before grants)	-1.0	0.9	-4.1	-0.6	1.6	2.7
Overall balance (before grants)	-8.9	-7.9	-14.8	-10.0	-7.7	-7.1
Overall balance (after grants)	-3.9	-2.7	-10.6	-6.0	-4.0	-4.3
External financing (net)	3.2	5.6	8.8	5.4	4.2	5.2
Domestic financing (net)	0.7	-2.9	1.4	0.6	-0.2	-0.9
Memorandum items:						
Total public debt*	39.9	50.9	56.6	73.6	69.5	65.9
External	34.5	42.4	48.1	63.6	60.8	59.1
Domestic	5.5	8.6	8.5	10.0	8.6	6.8

Source: GoM, IMF, and World Bank estimates and projections.

13. **Inflation rates have been relatively low and stable during the past two years.** Inflation was lower than projected in 2014, at 1.1 percent (year on year) in December. The yearly average in 2014 was down to 2.3 percent, well below the Central Bank's target of 5-6 percent. Low inflation reflects the strength of the metical against the South African Rand and a decline in commodity prices in international markets. Inflation continued low during 2015 but it has been accelerating, estimated at 2.41 percent (year-on-year) in September 2015 despite a weaker metical against the US$. After a long period of easing monetary policy, the Central Bank of Mozambique (BdM) increased policy rates by 25 basis points to 7.75 percent in October 2015.

14. **Lower exports and FDI inflows have put pressure on the metical in the past year.** Low commodity prices and somewhat weaker FDI inflows have put pressure on the metical, which has depreciated against the US$ from around 30 Mts/US$ in mid-2014 to 42 Mts/US$ by end of August 2015. Over the same period of time, international reserves have declined from US$3.2 billion in August 2014 to US$2.3 billion by end September 2015. It will be important that authorities maintain a flexible exchange rate regime to allow adjustment to take place and avoid further loss of reserves.

15. **The financial sector remains robust.** Credit continued its strong growth, increasing by 28.4 percent in 2014 following a 28.7 percent increase in 2013 and with credit to the economy reaching 37 percent of GDP in 2014 (compared to 28 percent of GDP in 2012), led by rapid growth of credit to households. Credit growth has decelerated in 2015, reaching 21.4 percent in July 2015. The ratio of deposits to credit remains healthy at 127.1 percent in December 2014. Profitability levels have recovered with Returns on Assets (ROA) and Return on Equity (ROE) at 2.1 percent and 22.2 percent in 2014 respectively. Liquidity is abundant as demonstrated by a ratio of liquid assets to total assets of 30 percent in December 2014. Non-performing loan ratios have risen from 2.3 percent in December 2013 to 3.3 percent in December 2014 which could be the result of a combination of stricter NPL regulations and as such is viewed by the BdM as a one-off adjustment. Credit to the economy is expected to grow at an average of about 16 percent in 2015-2017, which shows a healthy growth and also reduces the risks of overheating.

16. **Mozambique's export basket remains very limited, reflecting the narrow scope of the economy: in 2014, four items (aluminum, coal, gas and electricity) accounted for 57 percent of exports.** Total exports grew at an average annual rate of 10 percent from 2007 to 2014, driven by megaprojects in aluminum, coal and natural gas industries. Coal mining began in mid-2011 and is expected to become a major export, although infrastructure constraints and declining coal prices may affect development prospects. Ultimately, natural gas is projected to dominate the export mix toward the end of the decade.

17. **The current account deficit narrowed slightly to 34 percent of GDP in 2014.** Savings remain relatively low and insufficient to finance the large investments being made by the public and private sectors. As a result, the current account deficit has over the past few years been between 35 and 45 percent of GDP. The current account deficit narrowed to US$5.8 billion (or 34 percent of GDP), the result of a lower trade deficit. The current account deficit is to a large extent financed by large FDI inflows to develop the coal and gas industries. While consumption or intermediate goods imports increased by 20 percent over the past two years, capital goods imports increased by 85 percent over the same period. FDI reached between US$5-6 billion in 2012 and 2013 and is estimated at US$4.9 billion in 2014, or around one-third of GDP, and financed 85 percent of the current account deficit. This trend compares favorably to most of the last decade, when FDI financed 35 percent of the deficit. Balance of payments pressures over the past year suggest that despite these large FDI inflows, the large current account deficit has the capacity to affect macroeconomic stability.

18. **Public debt (in nominal terms) has grown rapidly, from 40 percent of GDP in 2012 to an estimated 57 percent in 2014.** This increase reflects the growth of domestic and external debt. An increasing share of this debt has been contracted on non-concessional terms. As a result, the joint WB-IMF Debt Sustainability Analysis (DSA) for Mozambique (April 2014) increased the country's debt distress risk rating from low to moderate. The depreciation observed over the past year will increase the stock of public debt to 74 percent of GDP (projected). The present value of the debt to GDP ratio has reached 40 percent but the risk of debt distress continues to be considered moderate[5].

[5] A draft DSA currently under preparation shows the present value of external debt to GDP at 40 percent of GDP. Using the probability approach, which focuses on the evolution of the probability of debt distress over time for borderline cases, the draft DSA considers that Mozambique is at a moderate risk of debt distress. The probability approach, which allows for complementary, country-specific information, takes into account Mozambique's positive growth outlook as

New debt is being used to finance a large increase in infrastructure investment to close the country's infrastructure deficit. If infrastructure investments generate high returns, they could result in higher growth in the medium term. In the near term, Mozambique will need to moderate borrowing and ensure that it has the capacity to manage a larger debt burden and a more complex investment portfolio. There is limited information on fiscal risks but recent developments (see below) raise concerns regarding their management.

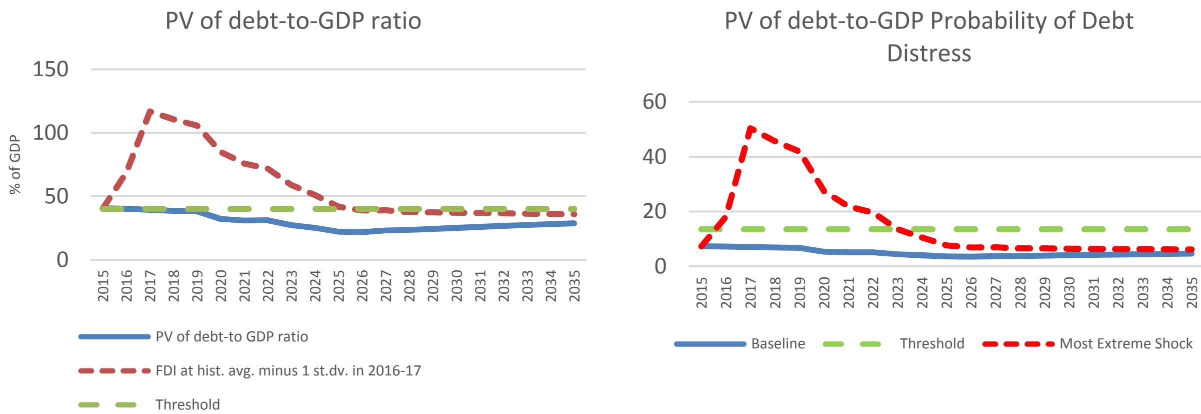
Table 4: Balance of Payments, 2012-2017

	2012	2013	2014	2015	2016	2017
	Act.	**Act.**	**Act.**	**Proj.**	**Proj.**	**Proj.**
		in US$ million				
Trade balance (goods)	-4,048	-4,357	-4,025	-3,532	-4,219	-7,070
Exports, f.o.b.	3,856	4,123	3,927	3,557	3,643	4,107
Of which: megaproject exports	2,173	2,201	2,440	2,186	2,069	2,340
Imports, f.o.b.	-7,903	-8,480	-7,952	-7,090	-7,863	-11,178
Of which: megaproject imports	-2,143	-1,934	-1,487	-802	-2,058	-5,087
Trade balance (services)	-3,706	-3,259	-2,932	-1,699	-1,231	-2,297
Other current account	963	1,363	1,170	635	550	264
Of which: external grants	538	460	568	441	462	356
Current account balance (a. grants)	-6,790	-6,253	-5,787	-4,597	-4,901	-9,104
Capital Account	490	423	372	424	368	378
Financial Account	6,644	6,202	5,279	3,350	4,790	9,245
Net foreign borrowing (gen. gov.)	544	1,056	1,398	925	754	956
Net foreign borrowing (priv. sec.)	32	125	76	298	1,538	1,638
Net FDI	5,626	6,175	4,902	2,880	3,188	7,376
Other investments	441	-1,154	-1,097	-752	-690	-726
Overall balance	375	393	-110	-823	258	520
Memorandum items:						
Current account balance (% of GDP)	44.7%	39.1%	34.1%	30.2%	33.1%	55.4%
Gross international reserves (US$ m)	2,604	2,995	2,881	2,146	2,481	3,022
In months of projected imports	2.7	3.3	3.9	3.0	2.3	2.0
In months of projected imports (exc. mega projects)	4.2	4.9	4.8	4.2	4.5	4.9

Sources: BdM, IMF and World Bank estimates and projections

well as its relatively high CPIA rating within the medium category. The draft DSA also stresses the need for cautious future borrowing to maintain debt sustainability.

Figure 5: Evolution of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015-2035. Traditional and probability approach to assess risk of debt distress.



Source: IMF and IDA. Forthcoming. "Mozambique Debt Sustainability Analysis," Washington DC.

19. **The issuance of a large bond with a Government guarantee by EMATUM (Empresa Moçambicana de Atum) in 2013 raised concerns about lack of transparency in the use of public funds, fiscal risks, and public investment management.** In September 2013, the Government-owned fishing company EMATUM issued publicly guaranteed bonds with a total value of US$850 million. The bonds were issued to finance investments in a tuna fishing fleet and coast guard and maritime security services. The Government assumed the part of the debt related to defense spending and the 2014 budget incorporated the costs of the coast guard and maritime security services, which are not commercial in nature (US$350 million). The operation may have contributed to delays in the implementation of other major infrastructure projects so that Mozambique would remain within the non-concessional borrowing (NCB) limit agreed in the IMF's policy support instrument (PSI).

20. **EMATUM may have significant fiscal implications, but the weaknesses in the operation are also being used to strengthen transparency and accountability.** Following discussions with development partners, the Government committed to subject EMATUM to strict financial controls and audits and to implement an action plan focused on improving public investment and fiscal risks management. External audits of EMATUM for 2013 and 2014 have been made publicly available (on the company's website) with an unqualified opinion. The Government has argued that a larger share of the proceedings of the bond were used for defense equipment (US$500 million) and is therefore likely to take on a larger share of the debt. The disclosure of the company's audits raised concerns about the company's ability to service its debt, starting with a bond redemption in September 2015. This led to the Government providing the necessary funds for servicing EMATUM's debt in September 2015. EMATUM developments have also led Standard and Poor to downgrade Mozambique's credit rating from B to B-. EMATUM is preparing a revised viability study that can be used to assess the company's viability and the amount of debt it can carry on its books going forward.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. **Mozambique's medium-term macroeconomic outlook is positive.** Annual growth is projected at 6.3 percent in 2015. The initial growth projection (of 7.5 percent) was revised downward as a result of the floods that affected the center and north of the country in early 2015 and a weak

external environment. Growth will slowly recover in 2016 and 2017 to reach slightly above 7 percent in 2017 as agriculture recovers from the 2015 floods and growth continues strong in the resource sector, construction, transportation and communications. In the short run, resource-related FDI, and infrastructure investments, both public and private, are expected to be major contributors to growth, despite projected weak commodity prices in the next few years. Liquefied Natural Gas (LNG) investments in Mozambique are expected to materialize on current market conditions. Further declines in commodity prices may have an adverse impact on Mozambique's economic prospects as it could affect the country's external balance and the timeline for investments in LNG plants in the north of the country.

22. **The authorities need to continue with the fiscal consolidation efforts.** The 2015 budget approved by parliament already starts a process of fiscal consolidation. Authorities plan to continue reducing public spending to below 34 percent of GDP by 2016 and the overall deficit (after grants) from over 10 percent in 2014 to 4 percent in 2016. The authorities expect that such a reduction in spending will be achieved given: the return of expenditure to a normal path after the implementation of one-off outlays on elections and maritime security in 2014; a plan to reduce the wage bill gradually from its elevated level of over 11 percent of GDP in 2014; and slower growth in expenditure on goods and services and investments. The 2016 draft budget sent by the government to parliament at the end of September 2015 foresees a continuation of the fiscal consolidation effort, a combination of restraining the wage bill and public investment. However, further efforts may be needed in 2016 in light of persistent BoP pressures. Moderating growth in the wage bill and the very large infrastructure investment program will allow the Government to continue allocating significant resources to the economic and social sectors, which have received 74 percent of the proposed 2016 budget (excluding debt servicing).

23. **The Central Bank will continue to maintain a policy stance consistent with single-digit inflation.** Inflation is projected to stay between 5-6 percent through 2017. After significantly easing monetary policies since 2013, BdM will focus on keeping inflation low through 2015. It will be important to monitor the impact of a weaker metical on prices of imported goods and the pass through to inflation. BdM's ongoing capacity-building efforts will strengthen Mozambique's monetary policy framework and enhance the effectiveness of its inflation-targeting regime. In early 2012, BdM started publishing a quarterly monetary policy report aimed at anchoring price expectations through more timely and transparent communication of recent economic developments and monetary policy decisions.

24. **The current account deficit will narrow on account of slowing investments in 2015 and 2016, but it is expected to quickly widen as FDI for the LNG plans in the Rovuma basin materializes.** The current account deficit is projected to decline to 30 percent in 2015 and slightly increase to 33 percent in 2016. This narrowing of the current account deficit is the result of declines in FDI, from US$5-6 billion over the past 3 years to around US$3 billion projected over the next two years. As investments in the Rovuma basin pick up during the second half of 2016 and 2017, the current account deficit will widen and reach 55 percent of GDP in 2017. Projected investments during the construction phase in the gas sector are several times the size of the entire Mozambican economy and as such, large current account deficits will continue through the end of the decade. These deficits will be financed by FDI inflows, projected to double to over US$7 billion in 2017 and continue increasing until the end of the decade. The anticipated rise in resource exports should improve the current account balance early in the next decade. Reserves are projected to recover in

the next few years to a projected US$3 billion by 2017, worth around 5 months of projected imports (excluding megaproject imports) during the same period.

25. **The total public debt stock is projected to decline over the next few years.** The depreciation of the metical resulted in increased debt levels as a share of GDP, given that most public debt is issued in foreign currency. Strong growth combined with a continuation of fiscal tightening, with greater reliance on concessional financing sources, will contribute to a gradual decline in Mozambique's debt levels, from a projection of 73.6 percent of GDP in 2015 to 65.9 percent of GDP in 2017. Furthermore, it would be important to improve debt management and investment planning capacity by prioritizing the different investments projects and at the same time reducing the pace of borrowing. The government is aware of the risks posed by inadequate controls on borrowing, and has expressed its intention to both slow the growth of new public external debt and reduce the share of non-concessional loans. The new Medium Term Debt Strategy, approved in October 2015, will also establish borrowing limits for the Government in the short and medium term. Debt remains sustainable, but it will be important to closely monitor debt dynamics and support the Government's efforts to improve its debt management capacity.

26. **Despite its positive overall economic outlook, the Mozambican economy faces significant downside risks, such as a sharp drop in commodity prices.** The increasing importance of FDI and natural resource exports leaves Mozambique's economy vulnerable to declining export demand, volatile commodity prices, and tighter global financial conditions. A further decline in commodity prices, possibly caused by current weaknesses in many emerging economies, may affect growth in Mozambique's nascent natural resources sector if investments are delayed. Sluggish growth in major trading partners also affects growth in Mozambique as well as its external position. In an environment of falling donor assistance, Mozambique may be faced with fewer financing options. In light of these risks, both the public and private sectors in Mozambique should avoid excessive leveraging backed by future rents from natural resources. Over the past two years, the Government security forces and the armed wing of the opposition party, *Resistencia National Moçambicana*/Renamo, have repeatedly clashed. Tensions continue after the elections, with Renamo demanding ability to govern the provinces where it gained a majority of the vote. Events in the last few years are a reminder of the potential for such tensions to have devastating economic and social consequences.

27. **Overall, Mozambique's macroeconomic framework provides an adequate basis for this operation**. This assessment is based on the country's strong macroeconomic performance over the past decade and the expectation that robust growth will continue in a stable and supportive policy context. The last year has seen significant volatility and weakness in the global economy, which has also affected Mozambique. The Government remains committed to prudent monetary and fiscal policies as evidenced by the fiscal consolidation effort reflected in the 2015 budget and monetary tightening starting in October 2015. Further policy tightening may be necessary to address continued external challenges. Macroeconomic management reforms are currently being supported through technical assistance (TA) and this operation.

IMF RELATIONS

28. **Mozambique started a new PSI with the IMF in 2013 and concluded its fourth PSI review in July 2015 and reached staff-level agreement for completing the fifth review in October 2015.** The IMF concluded a mission to hold discussions toward completing the fifth PSI review and reach an understanding on a new Stand-by Credit Facility (SCF) Arrangement in October 2015 (see Annex 3 for a press release). The mission reached a staff-level agreement for completing the fifth review and on an 18-month economic framework through 2017 that could be supported with about US$286 million under the IMF's SCF. The mission concluded that economic activity in 2015 remains strong but argued that new challenges, particularly on the external front, will require tightening fiscal and monetary policy. The mission also concluded that performance in implementing the PSI program has been mixed, with a number of quantitative targets missed and some delays in the implementation of structural reforms.

3. THE GOVERNMENT'S PROGRAM

29. **Mozambique has a newly elected president and Government since the beginning of 2015.** Following the October 2014 elections, Mozambique has had a new president since January 2015 who comes from the ruling party Frelimo and the new Government was announced shortly after. Frelimo also secured a strong majority in the parliament (144 seats out of 250 in total). Renamo, the largest opposition party and former rebel group, more than doubled its seats (89 seats), and the Movimento Democrático de Moçambique (MDM), a third political party with parliament representation, obtained 17 seats, also doubling its presence. Renamo has, since the election, demanded the formation of autonomous regions with significant autonomy in policy making.

30. **The Parliament approved in April 2015 the new Plano Quinquenal do Governo 2015-19.** The PQG 2015-19 has employment promotion, improving productivity and competitiveness as an overarching theme to achieve more inclusive growth. The PQG has five priorities: (i) consolidate national unity, peace and sovereignty, (ii) human and social capital development, (iii) promote employment and improve productivity and competitiveness, (iv) economic and social infrastructure development and (v) ensure sustainable and transparent management of natural and environmental resources. It also has three supporting pillars which are (i) consolidate the democratic rule of law, good governance and decentralization, (ii) promote a balanced and sustainable macroeconomic environment, and (iii) reinforce international cooperation. The PQG represents significant continuity in the focus of the Government program, but also some innovations. The plan avoids a sectoral approach to the country's development challenges using a better coordinated and integrated approach. The Government is also seeking greater integration of the cross cutting issues within the identified priority areas. Finally, the Government has elevated the sustainable and transparent management of its natural resources to one of the top priorities. Some of the priorities and objectives identified in the PQG conform with the IDA 17 special themes of inclusive growth, gender and climate change. Renewed focus of the new administration in supporting traditional economic sectors to promote employment generation makes the PQG closely aligned to the World Bank twin goals.

31. **The Government of Mozambique wants budget support donors to align themselves to the Government's PQG 2015-19 and to support the priorities identified in this program.** In a departure from the past, the Government of Mozambique will not be preparing a separate poverty reduction strategy, part of an effort to streamline and consolidate its planning instruments. The

Government wants development partners to support the priorities identified in the PQG 2015-19 after the finalization of the Action Plan for the Reduction of Poverty (PARP) in 2015. Budget support partners are engaged in discussions with the Government to define a clear performance matrix based on the new PQG on which Government progress can be assessed and to form the basis for providing budget support from 2016 onwards. The PQG is operationalized through annual implementation plans (*Plano Económico e Social – PES*) and budgets (*Orçamento do Estado – OE*), both approved by the national assembly.

32. **The Government's Poverty Reduction Strategy (PARP) is coming to an end in 2015.** The PARP was extended by one year to the end of 2015, providing a transition period from the PARP that guided Government efforts for poverty reduction and support by budget support donors, to the new PQG 2015-19. The PARP's overarching focus is on achieving accelerated economic growth and employment creation, and its key objective is to reduce the national poverty rate from its current 54.7 percent to no more than 42 percent by 2014. The PARP's three strategic pillars are: (i) boosting productivity in the primary sector, particularly agriculture and fisheries; (ii) promoting strong employment growth by attracting increased investment and building the human capital of the labor force; and (iii) supporting improvements in social indicators. The two cross-cutting support pillars are good governance and macroeconomic stability. Progress in PARP implementation is assessed through yearly reviews conducted jointly by the Government and budget support partners on the basis of the PARP performance assessment framework (PAF). Over the past few years, the number of budget support partners has declined from 19 to 14[6] and the framework to provide budget support is coordinated under a new Memorandum of Understanding (MoU) signed in September of 2015 by the Government of Mozambique and all budget support providers.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

33. **The proposed PRSC-11 would be the third and last in a series of three annual operations.** The PRSC series is harmonized with the joint-donor mechanism for the provision of general budget support and guided by the MoU signed by GoM and budget suppor donors. Reforms supported by the PRSC series are in line with the PARP's strategic pillars and the objectives defined in the PARP results matrix.

34. **The proposed operation will support Mozambique in achieving the Bank's twin goals of ending extreme poverty and promoting shared prosperity**. The ability of growth to reduce poverty in Mozambique has been disappointing over the past decade. This is related to the growth pattern, driven by large capital intensive projects. The discovery and investments in the mining and hydrocarbon sectors, often through large capital intensive projects with limited links to the rest of the economy, may contribute to a growth pattern that, as in the past, does not lead to significant poverty reduction. The reforms supported by this operation will contribute to a more inclusive growth pattern, as discussed in Section 5 of this document.

[6] The 14 partners are the African Development Bank, Austria, Canada, the EU, Finland, France, Ireland, Italy, Portugal, Spain, Sweden, Switzerland, the UK and the World Bank.

Previous PRSC Series and Lessons Learned

35. **The Bank's support for Mozambique's three successive poverty reduction strategy papers has continued for a decade.** The successive PRSC series, which began in 2004, have facilitated improvements in public sector capacity, the efficiency of public finance management and the business environment. The previous set of three operations (PRSCs 6-8) followed closely the joint Donors-GoM performance framework and was consistent with the contemporaneous CPS for FY2008-2011.

36. **The implementation of the previous PRSC series provided important lessons.** They include (i) the need to have a results framework with clearly specified policy and institutional reforms with outcome indicators that are linked to concrete actions, (ii) the importance of having strong monitoring and evaluation (M&E) systems, and (iii) the need to take capacity constraints into account in the design of reforms and address them through targeted capacity building and technical assistance activities.

37. **The PAF must be driven by clearly specified policy and institutional reforms, ensuring that outcome indicators are linked to concrete actions**. In the past, the PRSC has used the joint Donors-GoM PAF (Performance Assessment Framework). This PAF is focused on monitoring the achievement of desirable results, but it does not include a prioritized agenda of well-defined policy measures. The results framework used for the current PRSC series, although largely aligned with the Government's PARP and the PAF used by the budget support donors, includes clearly specified policy and institutional reforms as well as clearly linked outcome indicators. This is a departure from the PAF used by other budget support donors. The budget support donors and the Government are currently working to design a new PAF that starting in 2016 better links policy actions with results sought.

38. **Strengthening M&E systems will be vital to the success of the PARP.** The considerable difficulty of precisely monitoring key indicators is a major cross-cutting challenge. The Directorate of M&E at the Ministry of Economy and Finance (MEF) continues to build its capacity, but it is currently unable to meet the considerable M&E demands imposed by the numerous interventions and policies included in the PARP. Although the National Statistical Institute (INE) is also increasing its data-collection and analytical capacities, this will not necessarily translate into better quality M&E in the short run. The Bank has provided technical assistance to the M&E directorate and is an active member of the joint GoM-donors working group on monitoring and evaluation. The Bank has also provided technical assistance to INE in the design and implementation of the new household survey to improve the Government's ability to monitor the impact of policies on poverty.

39. **Implementation capacity constraints must be identified and used to guide the provision of technical assistance.** The PARP is ambitious and complex, and capacity constraints at multiple levels of Government may affect the implementation of reforms. Meeting these challenges will require an appropriately designed and targeted technical assistance program in the short run, coupled with sustained capacity-building support over the long run. The Bank supports the implementation of reforms included in this series through technical assistance and capacity building activities to take into account the capacity constraints identified, as explained in detail in the next section.

40. **Implementation of reforms in PRSC-9 and PRSC-10 has informed the preparation of this last operation in the series.** There is significant continuity in the reforms being supported and few changes between the triggers for PRSC-11 identified at the time of PRSC-10 board presentation and the proposed prior actions, illustrating the Government commitment to the reforms. The Implementation Status and Results prepared for PRSC-10 has informed the preparation of this operation, including the need to work closely with Government counterparts in the implementation of reforms to improve public investment management, particularly taking into account institutional reforms in the Ministry of Economy and Finance that may affect implementation. At the same time, the Government is making significant progress in improving the institutional set up for the management of fiscal risks, as reflected in the policy matrix for this operation. The Government remains committed to improving payment systems for all beneficiaries of social assistance programs. The PRSC had envisioned support to the outsourcing of payments to a private sector provider, as a way of improving the timeliness, predictability and transparency in transfers. Unfortunately, the tender process for the selection of the private sector provider had to be cancelled. This will be re-launched shortly and in the meantime the Government will adopt a series of alternative measures to achieve the same results, explained in detail in the next section. Table 5 summarizes the changes between the triggers identified for PRSC-11 in PRSC-10 and the prior actions proposed for this operation.

Table 5: Comparison of Triggers and Proposed Prior Actions for PRSC-11

PRSC-11 trigger identified in PRSC-10	PRSC-11 proposed prior action	Comments/ Status
The Government introduces the e-BAU, an integrated IT platform to further streamline business start-up procedures.	The Ministry of Trade and Industry has introduced the e-*BAU* to further streamline business start-up procedures	No change
Mozambique has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative (as approved on May 2013).	The Recipient has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative	No change
The Council of Ministers approves the implementing regulations for the revised Mining Law.	The Council of Ministers has approved the implementing regulations for Law No. 20/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Mining Law)	No change
The Council of Ministers approves the implementing regulations for the revised Hydrocarbons Sector Law.	The Council of Ministers has approved the implementing regulations for Law No. 21/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Hydrocarbon Law)	No change
The Government revises the system by which it transfers a share of the production taxes to communities and its use based on the experience accumulated.	The Ministry of Economy and Finance (MEF) has revised the system by which it transfers a share of the production taxes generated by mining and petroleum projects to communities in affected areas by budgeting a share of the	No change

PRSC-11 trigger identified in PRSC-10	PRSC-11 proposed prior action	Comments/ Status
	royalties collected during calendar year 2014	
INAS registers all beneficiaries of the PASP in the Single Registry of Beneficiaries (SRB).	INAS has registered 50% of PASP beneficiaries in the single registry of beneficiaries	The Government has started with the registration of all beneficiaries of the different programs, but registration is progressing slower than envisioned.
INAS adopts the formal payment system for all the PASP beneficiaries and all new PSSB beneficiaries.		Prior action not included because the Government was unable to outsource payments as envisioned. The Government remains committed to this reform and the same results as envisioned will be achieved through alternative measures to be implemented by the Government.
The Ministry of Planning and Development publishes (online) summary description of projects approved by the Council of Ministers, following the guidelines for project appraisal and evaluation.	MEF has mandated that all projects above fifty million United States Dollars (50,000,000) be submitted to MEF including a viability study	Results sought in the original trigger have been achieved. The proposed prior action strengthens the ability of the Ministry of Economy and Finance to evaluate large projects.
The Ministry of Finance revises the Medium Term Debt Management Strategy for 2014-2017 based on cost and risk analysis and relying on reliable debt data file generated by the debt management system.	MEF has prepared the Recipient's medium term debt management strategy for 2015-2018	No change
The Government clarifies the scope of the public sector, including a better definition of public funds and autonomous entities.	MEF has created a fiscal risks department within its Directorate for Financial and Economic Studies to better manage fiscal risks	The exercise to better define the scope of the public sector is taking place, but it will take longer than initially envisioned. To improve the management of fiscal risks, the Ministry of Economy and Finance has created a fiscal risks department, a new prior action to be included in this operation.

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

A. Improve the business regulations and investment climate and increase transparency in the management of extractive industries

Improving Business Regulations and Investment Climate

PRSC-11 Prior action 1: The Ministry of Trade and Industry has introduced the e-*BAU* to further streamline business start-up procedures

41. **Simplifying licensing requirements and streamlining procedures for starting a business are key elements of the Government's economic development policy.** The Government has

adopted the Strategy to Improve the Business Environment 2013-2017 as its new guiding document for regulatory reform. To further this agenda, the World Bank and IFC supported the compilation of a comprehensive inventory of over 700 business licenses. This facilitated the revision and consolidation of licensing procedures, which are now governed by the Simplified Licensing Regime (Decree 5/2012). In 2013 the Government established a set of new Commercial Licensing Regulations (Decree 34/2013)—a PRSC 9 prior action—which simplified business licensing in the areas of wholesale and retail commerce, services, imports and exports, and overseas commercial activity. In December 2013 the Government approved new Tourism Licensing Regulations. This new regime reduced and simplified licensing procedures and harmonized the classification of different types of tourism business with regional standards. In March 2014 the Government approved the industrial licensing decree – a PRSC 10 prior action. Together, these efforts have resulted in a reduction in the number of days required to obtain a commercial license, from 15 days to 8 days (10 days for activities without pre-inspection) and in the number of days required to obtain an industrial license, from 40 days to 20 days; a reduction in the total number of procedures required for regulatory compliance; and a 38 percent reduction in the cost of regulatory compliance.

42. **The Government has established e-BAU to further streamline business startup procedures online.** Private firms are now able to submit all required information at the Government's "one-stop shop" for business registration (BAU). This has cut the number of steps required for regulatory compliance from 9 to 5, a 44 percent reduction. The Government has introduced the e-BAU (prior action for PRSC 11), an integrated IT platform - allowing further streamlining through automation of business start-up procedures (registration, tax identification number processing, licensing of economic activities). Furthermore, the related 'Citizen Portal' increases access to information for business regulations by hosting information on valid business licenses, including needed procedures, requirements, downloadable forms, etc. Preliminary feedback from a pilot in 6 cities (Maputo, Xai-Xai, Inhambane, Beira, Nampula and Pemba) suggests that the system results in lower processing times, but also some problems with the reliability of the necessary infrastructure (electricity, internet). Once the integrated platform and simplified procedures are implemented nationwide, the amount of time necessary to start a business will be reduced from 13 to 8.

Improving Transparency and Management in Extractive Industries

43. **The policies supported by this operation reflect all stages of the extractive industries value chain to ensure development of the sector in a sustainable way.** The mining and hydrocarbons regime and supporting regulations will help set up a clear legal, regulatory and contractual framework for the awarding of contracts in a competitive, transparent way. The fiscal regimes of the mining and hydrocarbons sectors and supporting regulations reforms will help attract further investments in these sectors. Clearer legislation would help in efficient revenue collection. Compliance to the EITI would ensure accountability. Reforms in public finance management would help not only improved management and allocation of these resources but also help with better coping mechanisms in the light of challenges inherent to natural resources exports vis-a-vis volatility, exchange rate appreciation and Dutch Disease. The revised system of transfer of natural resource revenues to the producing districts has these considerations.

PRSC 11 Prior action 2 – The Recipient has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative

44. **Mozambique published the fifth EITI report complying with the new EITI Standard.** EITI compliance, achieved in 2012, reflects the Government's strong commitment to managing the country's natural resource reserves in line with global best practices and a high degree of transparency. The fifth report, published in December 2014, maintains Mozambique's compliance with the EITI Standard (prior action for PRSC-11), adopted in May of 2013. The EITI Standard shifts focus toward more thorough analysis designed to inform the policy dialogue on resource management. While full disclosure of contracts with private firms remains an optional element of EITI, all major mining and gas contracts have been made public in Mozambique. Disclosure requirements will be reinforced by the new Mining and Petroleum Laws recently approved by the National Assembly. Mozambique is due for revalidation in 2016 and by the end of the program will remain a compliant member of EITI with further improvements in transparency. It will have published the reconciliation reports up to 2014 in the Government's public portal in line with the new and revised EITI guidelines.

45. **The national assembly passed in mid-2014 revised legislation for the mining and hydrocarbon sectors**. The revised legislation updates sectoral legislation dating back to 2001 (hydrocarbons) and 2002 (mining). The new legislation increases transparency in contract disclosure. In 2014 parliament passed the fiscal regimes for both mining and the hydrocarbons sector (prior action PRSC 10), both key to be able to attract further investment to the sector. While the legislation was successful in updating the legislative framework, the implementing regulations (prior actions for PRSC 11) will be important to concretize many aspects in the legislation. By the end of the series it is expected that all new contracts starting 2015 will be negotiated under the revised legislative framework, although the current weakness in commodity prices, and other factors pertaining to infrastructure and general business environment, may affect investor interest and therefore the number of contracts signed under the revised legislative framework.

PRSC-11 Prior action 3: The Council of Ministers has approved the implementing regulations for Law No. 20/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Mining Law)

46. **The Government has approved the implementing regulations for the Mining Sector Law.** The implementing regulation for the Mining Sector is a good piece of regulation that will continue to strengthen Mozambique's regulatory environment for mining. The regulation was approved by the Council of Ministers in mid-October 2015. The regulation expands significantly on types of licenses – it includes in addition to regular exploration and mining licenses processing, as well as construction licenses, reserved area licenses, small and artisanal scale (ASM – this type requires plans and reports) and micro licenses (*senha mineira*). Terms and conditions for each are clear and well specified. The institutional set up is not fully clarified (e.g. the role of the *Alta Autoridade da Industria Extractiva*, *Instituto Nacional de Minas*) and additional clarification may be needed in the future. Other areas where additional clarity may be needed is the function and authority of inspectors, the definition of local content as well as the interaction of this regulation with specific environmental as well as resettlement regulations (currently under preparation).

PRSC-11 Prior action 4: The Council of Ministers has approved the implementing regulations for Law No. 21/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Hydrocarbon Law)

47. **The Government has approved the implementation regulations for the Hydrocarbons Law in November 2015**. The regulation is well written and in line with international standards and covers a whole range of concession contracts and also discusses domestic delivery requirements of oil and gas, a key concern for the domestic industry. The implementing regulations improves the coverage of oil drilling and development operations as well as the coverage on third party access to infrastructure, bringing the regulation in line with the provisions of the revised Hydrocarbons Law.

Extractive Industries and Subnational Transfers

PRSC 11 Prior Action 5: The Ministry of Economy and Finance (MEF) has revised the system by which it transfers a share of the production taxes generated by mining and petroleum projects to communities in affected areas by budgeting a share of the royalties collected during calendar year 2014.

48. **The authorities have recently begun to share natural resource revenues with producing communities.** The 2007 mining and hydrocarbon legislation mandated that a certain percentage of revenues from production taxes (to be determined each year in the budget) must be channeled to community development in the areas where the projects are being implemented. This provision has been maintained in the revised mining and hydrocarbon sector legislation. Implementation started in 2013 (PRSC-9 prior action). The Government allocated 2.75 percent of the production taxes generated by extractive industries to seven localities in three resource-rich provinces: Topito in Nampula Province, Cateme, 25 de Setembro, Benga and Chipanda II in Tete Province, and Pande and Maimelane in Inhambane Province.[7]

49. **The Government has revised the system by which it transfers a share of the royalties to producing communities to avoid within year volatility of transfers.** The Government issued guidelines for the use of these transfers of royalties by subnational governments. These transfers are intended to finance local public investment projects, to be decided by local communities. Eligible projects must aim at building social and economic infrastructure, including schools, health centers, irrigation and drainage systems, community reforestation projects, public markets, roads and bridges, and water and sanitation systems. A recent assessment of the experience with these transfers, conducted jointly by the Government and the World Bank, suggests significant benefits but also the need to revise the transfer system to avoid excessive within-year volatility in transfers. Lower than anticipated prices and production volumes meant that there were large differences between the projected and realized royalties, and therefore the budgeted and actual transfers to communities. As a result, many producing communities spent excessive amounts of time planning and adjusting plans for transfers that did not materialize instead of implementing projects with the available resources. To avoid differences between budgeted and transferred amounts, the Government is now budgeting based on previous year's royalties collection which is known at the time of budget preparation (Prior action PRSC 11). The revised transfer system will improve execution rates by communities. In previous years, execution of these transfers was relatively low,

[7] The specific percentage (2.75) was determined by the government as part of a pilot process for allocating subnational transfers. One of the considerations in choosing this percentage—which is expected to increase over time—was not to exceed the current expenditure capacity of district governments. In addition, the transfer does not supplant other spending commitments at either the central or subnational level related to infrastructure or public services in these localities.

but execution is expected to increase to 80 percent by the end of 2016 as a result of the revised transfer system. The 2015 budget was approved only at the end of April 2015, which led to an execution of these transfers of only 3.4% of the budgeted amounts until June 2015, but this is expected to accelerate during the remainder of the year.

B. Strengthen Social Protection

Improving Access and Allocation of Social Protection System.

50. **A large proportion of Mozambique's population is highly vulnerable to shocks.** These include structural food insecurity during the annual agricultural cycle, unpredictable changes in food prices, and a range of natural disasters. Natural disasters such as floods, droughts, pests and cyclones can have a severe and lasting impact on household income, and they disproportionally harm the poorest. A study by the Bank[8] estimated the impact of various shocks on poverty: floods and cyclones reduced household expenditures by about 32 percent and increasing the poverty rate by 2 percentage points. Agricultural pests and drought each diminished consumption by about 17 percent and added between 1.2 and 2 percentage points to the poverty rate. When facing a shock, poor households are often forced to sacrifice their long-term interests for the sake of immediate needs. In the long run, these coping mechanisms make households poorer and more vulnerable, and they may transmit these adverse effects to future generations through their impact on education and health outcomes.

51. **The Government is expanding and improving social protection programs to be able to protect the poorest and most vulnerable.** Many social assistance programs are administratively or geographically fragmented, have low overall coverage, or are not well targeted. According to a Social Safety Net Assessment prepared in 2012[9], in 2011 the scope of major social-protection programs remained inadequate relative to the number of individuals at risk, and existing coverage was found to be highly uneven. The recent Mozambique Public Expenditure Review (2014) argues that some of these shortcomings have been addressed (generosity of benefits, coverage of social protection), but also suggests that further reforms are needed. The Government has strengthened the legal and institutional framework for social protection, including the Social Protection Law, passed in 2007 and the National Strategy for Basic Social Security (*Estratégia Nacional de Segurança Social Basica*—ENSSB), launched in 2009.

52. **The Government is expanding the ENSSB into a comprehensive social safety net through two main programs, the *Programa de Subsidio Social Básico* (PSSB) and the *Programa de Acção Social Productiva* (PASP).** The Government's strategy is based on the principle that different vulnerabilities require different interventions, but that these should be based on a common targeting system that identifies and registers beneficiaries in a single database. In 2011 the Council of Ministers created two major programs, which together would provide support to about 800,000 households once full implementation was reached.[10] These are the PSSB, a cash transfer program

[8] "Mozambique Poverty, Gender, and Social Assessment" World Bank, 2008.
[9] "Mozambique Social Protection Assessment" Report No. 68239-MZ. World Bank, 2012.
[10] República de Moçambique (2011) *Criação de programas de segurança social básica, no quadro da operacionalização da estratégia nacional de segurança social básica* (Creation of basic social security programs as part of the operationalization of the national strategy of basic social security), Maputo. Document approved by the Council of Ministers in September 2011.

for extremely poor households in which no adult is able to work and the PASP, a public works program for poor households in which one or more adults are able to work but face limited employment opportunities. In the first two years of implementation of public works, over 70 percent of the beneficiaries were women. The first phase of the PASP is currently being implemented and the program began scaling up in January 2015. The PSSB and PASP are complemented by the Direct Social Action Program (*Programa de Apoio Social Directo*—PASD), which provides short-term support to households that have been affected by a shock.

53. **Social safety net programs are being expanded to better serve the poorest and most vulnerable.** The Government has increased the budget allocation for social protection programs from US$13 million in 2008 to US$85 million in 2014, or 0.5 percent of GDP. The total number of beneficiaries registered by the National Institute of Social Action (*Instituto Nacional de Acção Social*—INAS) rose from 167,000 households in 2008 to 427,000 by 2014. By 2015, there were almost 40,000 direct beneficiaries in PASP, significantly higher than the target of 20,000 beneficiaries foreseen in the current PRSC series.

PRSC-11 Prior action 6: INAS has registered 50% of PASP beneficiaries in the single registry of beneficiaries

54. **Implementing effective social security policies requires an accurate, comprehensive and regularly updated registry of beneficiaries**. INAS has developed a single registry covering all beneficiaries of basic social assistance programs, starting with those enrolled in the PSSB and PASP (PRSC-10 prior action). The single registry of beneficiaries will be populated with beneficiaries of PSSB and PASP. After that, the system will be ready to be used by all social safety net programs. By end October 2015, the Government had registered 50 percent of all PASP beneficiaries (PRSC-11 prior action). The implementation of a registry of beneficiaries, together with the implementation of a proper targeting system, including a verification mechanism, will contribute to improved cost-efficiency and effectiveness of the social protection system. Around 10 percent of PASP beneficiaries have a consumption level above U$1.25 per capita per day, providing an indication of the level of leakage of the program to the non-poor. With an improved registry of beneficiaries and targeting system, the estimated leakage of the PASP program will decline to 2 percent by end of 2016.

55. **INAS has adopted the formal payment system for all PASP and new PSSB beneficiaries, although it has not been able to outsource payments to a private sector provider yet.** Late 2014, INAS launched a tender process to outsource the payments of all social protection subsidies to a private service provider. The tender process had to be cancelled due to a lack of acceptable bids. As a result, the current operation does not include the adoption of the formal payment system as a prior action. Despite this temporary setback, INAS remains fully committed to outsourcing the payments system to a private service provider and it will re-launch the tender process by the end of 2015 after revisions to the terms of reference and bidding documents to facilitate the procurement process. Meanwhile, INAS is implementing a number of measures in payments system for the beneficiaries of the Basic Social Subsidy Program (PSSB) and Productive Social Action Program (PASP), including a rigorous authentication process, improved reconciliation between amounts due and disbursements, enhanced monitoring and evaluation as well as a complaints handling mechanism. The adopted payments solution ensures that cash benefits will be timely, predictable and transparent, allowing eligible households to base their financial decisions on reliable expectations. The results to

be achieved have not changed, although they will be achieved through a more cumbersome process for the time being, and by the end of 2016 at least 50 percent of beneficiaries from PASP and PSSB will be paid within the month.

C. Enhance Public Finance Management

56. **Progress has not been even across all areas of PFM reform, but overall achievements have been considerable.** Public Expenditure and Financial Accountability (PEFA) indicators show the trajectory of improvement from 2006 through 2010, as the PFM reform program produced substantial improvements in fiscal policy and budget execution. A new PEFA is being conducted in 2015. Preliminary results suggest improvements in some areas (internal audit, fiscal risks and the timeliness of publication of budget information) while performance in other areas has worsened (scope of budget information published, controls in wage payments). SISTAFE legislation (2002), along with new PFM policies and procedures, provide the foundation for a reformed PFM structure, the implementation of which included the progressive expansion of the e-SISTAFE information-technology platform as one of its core elements. There has been considerable progress in rolling out e-SISTAFE across multiple public agencies, as well as expanding its functionality over time. E-SISTAFE now covers budget preparation as well as budget execution and the reporting of expenditures. Other important advances include the creation of a Treasury Single Account (Conta Única do Tesouro—CUT). The first procurement decree 54/2005 was published in 2005 and updated in 2010 (Decree 15/2010) in line with international best practices. Decree 141/2006 created the public procurement regulatory agency (*Unidade Funcional de Supervisão das Aquisições* - UFSA) and decree 142/2006 created public procurement executing units at the various levels of the public entities. The capacities of the Supreme Audit Institution (*Autoridade Tributária*) and the internal oversight coordinating body (*Inspecção Geral das Finanças*) have been enhanced to increase audit coverage.

57. **The PRSC series supported reforms to strengthen audit and oversight mechanisms that focused on strengthening internal and external audit follow-ups.** According to previous PEFA reports, there has been in the past limited management response to audit recommendations. As a result, the General Inspectorate of Finance (*Inspecção Geral de Finanças*—IGF) began developing a database in an effort to improve monitoring of the implementation of audit recommendations by public institutions in 2009. In this database, recommendations are classified by category—e.g. criminal, disciplinary, or procedural. The Government's internal audit institutions, the IGF, and the Internal Control Units (*Órgãos de Control Interno*—OCIs), have specifically allocated time for follow-up in their audit work plans, and data on audit follow-up is currently being collected. As a result of the ongoing policy dialogue between the Government and development partners, efforts are focusing on monitoring the number of audit recommendations made by each of the auditing institutions (including the AT, IGF, and OCIs) and record how many of these recommendations have been implemented. During 2014, 51 percent of all audit recommendations by IGF and the OCIs received appropriate follow up.

Improving Public Investment Management (PIM)

58. **Mozambique has a relatively high rate of public investment, averaging more than 15 percent of GDP during the past 5 years.** Public investment is projected to remain at relatively high levels over the medium term. However, the PIM capacity of many implementing agencies remains

relatively weak, and the large increases in investment in infrastructure envisaged under the Government's Integrated Investment Program (*Programa Integrado de Investimento*—PII) will further strain its limited institutional resources. The Government currently has low scores in all areas measured by the IMF's Public Investment Management Index (WP 11/37), but it scores particularly poorly on project appraisal, monitoring and evaluation, and the rigorousness of the selection process. As a result, planned investments may not have the intended impact, since the impact of public investment depends on a number of institutional factors, including the quality of the project planning, appraisal and selection processes, the effectiveness of project management, and the monitoring and evaluation of both ongoing and completed investments.

59. **The Government has recognized the need to strengthen its PIM system.** In March 2011 the Government established the Public Project Coordination and Selection Committee (*Comité de Coordenação e Selecção de Projectos Públicos,* CCSPP), an organ of MEF that advises Government on the prioritization and selection of public investment projects. The CCSPP is chaired by a representative of MEF and includes staff from MEF, BdM and infrastructure-related sector ministries. It is supported by a technical secretariat in the Directorate for Economic and Financial Studies in MEF. The mandate of the CCSPP includes (i) selecting and prioritizing public projects in accordance with the Government's objectives; (ii) guaranteeing that project selection follows an established set of objective criteria; and (iii) preparing independent assessments of proposed investment projects and submitting these assessments to the Social and Economic Council, a Cabinet-level body that approves large investment projects. The CCSPP is complemented by a Debt Management Committee, and the two coordinate to ensure that the public investment program is consistent with debt sustainability.

60. **The Government has developed a series of tools that will contribute to improved appraisal and evaluation of projects.** A recent report prepared by the Bank for the Government of Mozambique on the necessary reforms to strengthen public investment management[11], suggested the need to adopt a methodology to guide project appraisal and evaluation. The Government prepared and adopted a Manual for the Appraisal and Evaluation of Public Projects to guide project preparation and establish a standard set of criteria for assessing project proposals (prior action for PRSC-9). The Government published the Programa Integrado de Investimentos which helps in the prioritization of public investment projects and exploits complementarities between projects (prior action for PRSC-10) based on a 3-year rolling investment program. A revised PII was published in late 2014 which included summary information of all investment projects included in the PII. Several partners, including the Bank, have been supporting capacity building activities for project appraisal and evaluation in the relevant government agencies. The Mozambique Integrated Growth Poles Project (Report No: PAD268) includes a component that will provide public investment management-related capacity building activities and technical assistance to the Government, which will focus on project planning, proposal evaluation and implementation monitoring.

PRSC-11 Prior action 7: MEF has mandated that all projects above fifty million United States Dollars (50,000,000) be submitted to MEF including a viability study.

61. **At the same time, the Government is strengthening the regulatory framework for project appraisal and evaluation.** MPD and MoF revised their methodology to prepare the Medium Term

[11] World Bank, 2013, "Proposta de melhoria do sistema de investimento público em Moçambique"

Fiscal Framework making project appraisal mandatory (prior action for PRSC-10). In 2015 the Ministry of Economy and Finance issued a circular that mandated that all projects above US$50 million be submitted to the Ministry of Economy and Finance, together with a viability study (Prior action PRSC 11). This stronger regulatory framework is crucial to avoid the selection of poor projects for implementation. Reforms to improve the PIM system will need to be better integrated with the reform of the overall planning and budgeting systems currently underway. The old Ministries of Planning and Development and Finance have been merged in the new government into a Ministry of Economy and Finance, partly to improve the linkages between planning and budgeting processes. These institutional changes have affected the pace of reforms, but a stronger Ministry with a clear mandate to better link investments and financing will be better able to strengthen PIM systems. By the end of the program, all public investment projects included in the Integrated Investment Program will have been appraised and evaluated.

Improving Public Debt Management

62. **Increasing infrastructure investments without compromising fiscal sustainability will require the Government to strengthen its debt management capacity, as much investment will be financed through borrowing.** In 2014 Mozambique's total public external debt stock was 48 percent of GDP. This relatively high but manageable debt-to-GDP ratio reflects Mozambique's completion of the Heavily Indebted Poor Countries program in 1999 and the Multilateral Debt Relief Initiative in 2006, as well as the prudent macroeconomic and fiscal policies pursued by the country over the past two decades. Faced with a decline in donor support, the Government has increased its use of non-concessional financing to support public investment, which has increased risks to debt sustainability. Consequently, debt management has become an increasingly important policy area.

63. **The Government has improved its debt management capacity over the past several years, but challenges remain.** In March 2011 the Government established the Public Debt Management Committee (*Comité de Gestão da Divida Publica*—CGDP). The CGDP is a consultative and advisory body in MEF; it is coordinated by the National Treasury Directorate and includes staff from MEF and BdM. The mandate of the CGDP includes (i) periodically revising and updating the Government's official Public Debt Strategy; (ii) monitoring trends relevant to public debt and evaluating their potential impact; (iii) proposing recommendations to improve debt management with an emphasis on minimizing vulnerability to external shocks; and (iv) analyzing debt dynamics and identifying possible threats to debt sustainability. The Bank and IMF are providing technical assistance to the Government to improve its debt management capacity.

PRSC-11 Prior action 8: MEF has prepared the Recipient's medium term debt management strategy for 2015-2018

64. **In 2015 the Government revised the Medium Term Debt Management Strategy.** In September of 2012 the Government adopted a Medium-Term Debt Management Strategy for 2012-15 (prior action for PRSC-9), guiding the Government's borrowing practices. As part of its efforts to improve debt management, the Government formulated and implemented during 2013 its first annual domestic borrowing plan (prior action for PRSC-10), designed to improve internal planning and communication between the Government and private capital markets. The Government also publishes quarterly debt reports, which began in late-2011, providing up-to-date information on the new evolution of public and publicly guaranteed debt. The Government has prepared a revised

Medium Term Debt Management strategy (prior action for PRSC-11). By the end of the program, quarterly public debt reports will have been prepared for the 2013 and 2014 fiscal years and published in the Government's public portal. The publication and implementation of the first annual domestic borrowing plan has resulted in improved adherence to borrowing plans issued.

PRSC-11 Prior action 9: MEF has created a fiscal risks' department within its Directorate for Financial and Economic Studies to better manage fiscal risks

65. **The anticipated influx of resource revenues will significantly increase the complexity of public finance management and the need to better manage fiscal risks.** The provision of a government guarantee in mid-2013 in the amount of US$850 million to EMATUM, a newly established tuna fishing company, raised concerns on the fiscal risks that this operation entailed. Large-scale revenues from extractive industries will afford Mozambique access to new financial instruments and debt financing options that would not otherwise be available, including loans to finance the Government's equity stake in extractive industry projects. These more complex financing instruments could generate increased fiscal risks, and the recent Public Expenditure Review for Mozambique suggests that this may already be happening. Contingent liabilities accumulated by public enterprises through explicit or implicit public guarantees, the long-term spending obligations incurred by social programs and the risks associated with large multi-annual contracts for infrastructure projects are not recognized or analyzed in Mozambican budget documents and there is currently no strategy for managing them in a comprehensive manner[12].

66. **Mozambique will need to establish a system for better assessing and managing fiscal risks.** Without a comprehensive accounting framework, the accumulation of contingent liabilities and off-budget expenditures could jeopardize an otherwise balanced fiscal stance. The authorities have set up a new fiscal risk unit in the Directorate for Economic and Financial Studies in MEF (Prior action PRSC11), which would analyze the implications of government guarantees, public enterprises, and public-private partnerships. The Bank has provided technical assistance to clarify the scope and mandate that such a unit could have. Other government efforts to improve the management of fiscal risks include new legislation and implementing regulation for the management and supervision of SOEs (PRSC 10 prior action) as well as the drafting of new legislation that will improve governance of the state's corporate sector. As a result of reforms in the area of fiscal risks, at the end of the program the Government will include a fiscal risks statement in budget documentation.

Analytical Underpinnings

67. **The proposed operation is based on a body of analytical work produced by the Bank and Mozambique's other development partners**. This analytical foundation informs the design of the reform program supported by the PRSC series and guides the provision of technical assistance. Table 6, below, presents an overview of relevant economic and sector work and its contribution to the proposed operation.

[12] World Bank, 2014, "Mozambique Public Expenditure Review"

Table 6: Analytical Underpinnings

Analytical Reports	Findings and Recommendations	Links to the PRSC Series
Mozambique: Country Economic Memorandum: Reshaping Growth and Creating Jobs through Trade and Regional Integration (2012) World Bank	Provides an in-depth analysis of the Mozambican economy, assessing recent trends with a focus on the relationship between trade and employment.	Relevant to almost every aspect of the proposed operation. A number of prior actions and triggers on the objective 1 in the proposed PRSC series reflect some of the constraints to growth that need to be overcome (prior action 1)
Poverty in Mozambique: New Evidence from Recent Household Surveys (2012) World Bank	Reviews the methodology used to determine poverty rates at the national, regional and provincial levels and presents a set of revised poverty estimates, revealing important trends in interregional and rural/urban poverty dynamics.	Relevant to the poverty assessment underpinning the proposed PRSC and reforms to social assistance (prior action 6)
The Future of Natural Gas in Mozambique: Towards a Gas Master Plan (2012) World Bank.	Assesses recent developments in the natural-gas sector and establishes the basis for a comprehensive sectoral policy framework.	Relevant to reforms related to the extractive-industries sector and informs the economic development measures included under objectives 1 of the proposed PRSC series (prior actions 2-5)
Mozambique: Investment Climate Assessment (2009) World Bank (AFTFP)	Assesses obstacles to investment and private-sector development in Mozambique, and provides a set of options for addressing these challenges.	Relevant to the business- and investment-climate reforms supported by the proposed operation (prior action 1)
Enhancing Macroeconomic and Fiscal Policy for Inclusive Growth during a Commodities Boom (Programmatic AAA, forthcoming) World Bank	Evaluates the macroeconomic implications of the rapid growth of the extractive-industries sector and offers recommendations for process improvements to fiscal policy and budgetary systems.	Relevant to public finance management reforms supported by the proposed operation (prior actions 7-9)
Mozambique: Social Protection Assessment: Review of Social Assistance Programs and Social Protection Expenditures (2011) World Bank (Social Protection)	Analyzes the current state of social protection policies in Mozambique and identifies key challenges facing the Government’s social assistance strategy.	Relevant to the social assistance agenda encompassed under objective 2 of the proposed operation (prior action 6)
Mozambique Public Expenditure Review	Analyzes macro-fiscal trends and sectoral patterns of spending. Discusses the emergence of fiscal risks and suggests ways to manage them better as well as the need to improve management of public investment management.	Relevant for prior actions in the 3rd objective of this operation (prior actions 7-9)
World Bank, 2013, “Proposta de melhoria do sistema de investimento público em Moçambique”	TA report with recommendations on steps to reform Mozambique’s public investment management system	Relevant for prior actions on public investment management (prior action 7)
World Bank, 2014, “Sharing Natural Resource Revenues with Affected Communities: Policy Options for Mozambique”	Policy Note assessing Mozambique’s experience with sharing revenues from natural resources with affected communities	Relevant for reforms in natural resources revenue sharing (prior action 5)

Analytical Reports	Findings and Recommendations	Links to the PRSC Series
World Bank, 2014, "Proposed Fiscal Risks Analysis for Mozambique"	TA report with recommendations on the scope and mandate of a new Fiscal Risks Unit to be created in MEF	Relevant for reforms in fiscal risks management (prior action 9)
MPD, 2013, "2012 Survey of Mozambican Manufacturing Firms"	Survey of Mozambican manufacturing firms that identifies constraints to the business environment	Relevant for prior actions in the first objective of the PRSC series (prior action 1).
IMF, 2014, "Republic of Mozambique - Refocusing the Public Financial Management Strategy"	IMF report on PFM reforms in Mozambique	Relevant for prior actions on public finance management (prior actions 8-9)

4.3 LINK TO THE CPS, OTHER BANK OPERATIONS AND THE WBG STRATEGY

68. **The proposed PRSC-11 is a key element of the Bank's CPS for FY2012-15.** The CPS identifies this PRSC series as one of the instruments that the Bank has to support a more inclusive growth process and envisages annual PRSC operations for each year of its implementation. Reforms are also supported by other sectoral budget support operations as well as a very wide portfolio of investment projects (see below). The proposed PRSC-11 is designed to focus on developing the strong, supportive economic and regulatory infrastructure necessary to sustain inclusive growth. The PRSC-11 is closely aligned with CPS supported reforms to improve the business climate, strengthen public finance management, and maximize the growth impact of the rising resource sector. The PRSC-11 directly supports objectives under each of the CPS's two strategic pillars, (i) Competitiveness and Employment, and (ii) Growth and Resilience, as well as its cross-cutting Governance and Public-Sector Capacity agenda.

69. **The PRSC-11 is one of several budget support operations in Mozambique.** The PRSC-11 is prepared in parallel to 3 additional DPO series to support reforms in climate change, agriculture and the financial sector. In addition, the Mining and Gas Technical Assistance Project (MAGTAP), approved by the Board on March 2013, will further the goals of the proposed PRSC by building the administrative and oversight capacity of the Government with respect to the resource sector. The Growth Poles Project and IFC technical assistance complement the private sector reforms supported by the proposed PRSC-11, while the Social Protection Project (SPP) directly supports the Government's efforts to operationalize its social protection strategy. The reforms supported by this operation also support the objectives of the Climate Change DPO series, by ensuring that social and environmental aspects are considered in all public investments and that the independent evaluation of project appraisals follows this up. Finally, two education projects—the Higher Education, Science and Technology project and the Technical and Vocational Education and Training project—bolster the proposed operation's private sector growth objectives by strengthening the human capital of the labor force.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

70. **A Memorandum of Understanding (MoU) was signed in September 2015 between the Government and the budget support donors, which includes the World Bank.** This MoU revises the one signed in 2009 and defines a set of fundamental principles for budget support. These are: (i) predictability and alignment with domestic systems; (ii) joint monitoring and the consistent use of the PAF; (iii) consolidated reporting; and (iv) mutual accountability. Under the revised MoU the focus of the partnership has remained very similar. The Bank and IMF continue to work together to support the implementation of the PARP and the PQG, pursuing joint efforts in a number of priority areas, including financial sector oversight, debt dynamics and external debt sustainability, and the responsible management of natural resources.

71. **This operation supports the implementation of PARP and other Government reforms that benefit from broad-based consultations.** The preparation of PARP, which outlines the Government's strategy for reducing poverty, benefitted from wide ranging consultations with civil society and other stakeholders. PARP implementation is assessed through yearly reviews that also benefit from consultations with civil society. Several of the reforms supported by this operation have also benefitted from additional consultations with interested stakeholders, such as the EITI process or the implementing regulations of the mining and hydrocarbon sectors. The Government's annual planning and budgeting process also benefits from wide-ranging consultations. Given the participatory nature of the planning process and the additional consultation processes that were put in place as needed, no additional consultations took place in the preparation of this operation.

Table 7: Prior Actions, PRSCs 9 to 11

Outcomes Sought	**Description of Reforms**	**PRSC-9 Prior actions**	**PRSC 10 Prior actions**	**PRSC 11 Prior Actions**
Pillar 1: Improve business regulations and investment climate and increase transparency in the management of extractive industries				
Improving Business Regulations and Investment Climate.	Simplification and harmonization of the business licensing system.	The Council of Ministers has approved the Commercial Licensing Decree.	The Council of Ministers has approved the Industrial Licensing Decree.	
	A process for streamlining business registration is implemented.		The Council of Ministers has adopted a single form for opening a new business and start activities.	The Ministry of Trade and Industry has introduced the e-*BAU* to further streamline business start-up procedures
Improving transparency and management in extractive industries.	Increased transparency and approval of legislation on extractive industries.	Mozambique has achieved compliance with the standards of the Extractive Industries Transparency Initiative (EITI).		The Recipient has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative
		The Council of Ministers has approved the draft Mining Law and has sent it to its National Assembly for approval.		The Council of Ministers has approved the implementing regulations for Law No. 20/2014 dated 18 August 2014 published in the

Outcomes Sought	Description of Reforms	PRSC-9 Prior actions	PRSC 10 Prior actions	PRSC 11 Prior Actions
				Boletim da República No. 66 Serie I on 18 August 2014 (the Mining Law)
		The Council of Ministers has approved the draft Hydrocarbons Sector Law and has sent it to its National Assembly for approval.	The Council of Ministers has approved the bill defining the fiscal regime for the hydrocarbon sector and has submitted the bill to its National Assembly for approval.	The Council of Ministers has approved the implementing regulations for Law No. 21/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Hydrocarbon Law)
	Promote economic development of local communities in the proximity of the areas of extractive industries via investment in public infrastructure.	The State Budget for 2013 has allocated 2.75 percent of revenues generated by extractive industries to districts for infrastructure development of communities in which the extractive industries operate.		The Ministry of Economy and Finance (MEF) has revised the system by which it transfers a share of the production taxes generated by mining and petroleum projects to communities in affected areas by budgeting a share of the royalties collected during calendar year 2014
Pillar 2: Strengthen Social Protection				
Improving Access and Allocation of Social Protection Systems.	Better coordination of social protection programs through a single registry of beneficiaries.		INAS has developed and adopted a single registry of beneficiaries for all INAS programs providing cash to beneficiaries.	INAS has registered 50% of PASP beneficiaries in the single registry of beneficiaries
	Expansion of social safety net programs among the poorest and most vulnerable.	The Council of Ministers has approved the PASP which was scaled-up in the 2013 State Budget to increase the number of beneficiaries.		
	Improving transparency in the provision of benefits of social safety net programs.	The Coordinating Council of the System of Basic Social Security has authorized INAS to outsource the payment of cash benefits for its social safety net programs.	INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the payment distribution system.	
Pillar 3: Enhance Public Finance Management				
Improving the management	Enhanced quality and effectiveness of audit mechanisms, as reflected	The Ministry of Finance has developed a systematized database		

Outcomes Sought	Description of Reforms	PRSC-9 Prior actions	PRSC 10 Prior actions	PRSC 11 Prior Actions
of audits, public investment and public debt.	in the percentage of recommendations implemented by the entities audited/inspected by the OCI's and IGF.	which contains the recommendations for, and the current status of, its implementation, thus allowing effective follow-up so that 20 percent of IGF and OCI audit recommendations were implemented.		
	Development and Institutionalization of a Public Investment Management Process.	The Ministry of Planning and Development has adopted the Manual for the Appraisal and Evaluation of Public Projects.	The Ministry of Planning and Development and the Ministry of Finance have issued a revised methodology for the elaboration of the medium-term fiscal framework making appraisal of public investments mandatory for all projects in excess of USD 5 million equivalent.	MEF has mandated that all projects above fifty million United States Dollars (50,000,000) be submitted to MEF including a viability study
			The Council of Ministers has adopted the *Programa Integrado de Investimentos 2014-2017*.	
	Improve debt and fiscal risks management to ensure debt sustainability.	The Council of Ministers has approved the Medium-Term Debt Management Strategy (2012-2015).	The Ministry of Finance has implemented the first annual domestic borrowing plan, prepared based on the medium term debt management strategy.	MEF has prepared the Recipient's medium term debt management strategy for 2015-2018
			The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012).	MEF has created a fiscal risks department within its Directorate for Financial and Economic Studies to better manage fiscal risks

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

72. **The policies supported by this series are expected to have a positive or neutral impact on poverty and social indicators as outlined below.** The PRSC operation supports inclusive growth by taking into account the constraints in the current growth pattern. Several analytical pieces have discussed the current growth pattern in Mozambique and the reasons for reduced or slower poverty reduction recently. Some of these constraints are being addressed by the Government along with

efforts from development partners. These include (i) the need to ensure that megaprojects generate a fair stream of revenues for the Government, (ii) the need to expand and improve social protection systems, (iii) the need to focus on the constraints of the private sector, and (iv) the need to increase investments in agriculture and improve services provision. The paragraphs below discuss how the reforms supported by this operation will have a positive or neutral impact on poverty and social indicators.

73. **Reforms to simplify business regulations and start up procedures (prior action 1) will lead to increased productivity of the private sector and through it employment creation**. A recent survey of manufacturing firms revealed that over 30 percent of all firms identified business licensing and registration as a major constraint to growth. Improving the business environment in general and more specifically simplifying business regulations has a positive impact on growth and employment (Hanush, 2012; Barseghyan, 2008; Bruhn, 2011)[13]. By reducing the time (and related costs) needed to start a business and obtain a license, this reform will lead to higher investment, productivity and increased employment creation.

74. **The development of the mining and gas sectors (prior actions 2-5) bring significant opportunities to Mozambique**. This series supports reforms for improved transparency and management in extractive industries. The revised sectoral laws for mining and hydrocarbons, new fiscal regimes and implementing regulations will improve the regulatory environment for extractive industries. An improved regulatory regime will promote investments in the sector while the revised fiscal regime ensures that the Government is able to capture a fair share of the rents generated. Communities and households affected by extractive industries are adequately protected by the Land, Environment Law and Resettlement Regulations. The law states that all land belongs to the State and households and communities enjoy “surface rights” legally laid out in DUATs (land use right titles). DUAT land can be expropriated if found necessary for public good and the law guarantees the need for adequate compensation for surface rights. Under the Land, Environment Law and Resettlement Regulations no operation can start before any required compensation and resettlement process has been completed.

75. **The extent to which Mozambicans benefits from the development of the mining and hydrocarbons sectors will depend on the use that the Government makes of natural resource revenues and how transparently they do so (prior action 2).** As discussed in a recent policy note prepared by the Bank[14], revenues from coal and gas may reach US$9 billion per year towards 2030, accounting for over 20 percent of all revenues. Transparency in the use of resources will contribute to a more judicious use of resources and sharing of benefits. Transparency is being supported by Mozambique’s compliance with the Extractive Industries Transparency Initiative.

76. **The proposed PRSC directly contributes to poverty alleviation through its focus on enhancing the scope, targeting and overall efficacy of social protection programs (prior action 6).** Detailed analysis of the social and poverty impact of enhancing social protection programs was

[13]Hanush, Marek, 2012, “The Doing Business Indicators, Economic Growth and Regulatory Reform”, Policy Research Working Paper Nr. 6176, The World Bank; Barseghyan, Levon, 2008, “Entry Costs and Cross-Country Differences in Productivity and Output”, Journal of Economic Growth, 13: 145-167; Bruhn, Miriam, 2011, “License to Sell: The Effect of Business Registration Reform on Entrepreneurial Activity in Mexico”, The Review of Economics and Statistics, 93-1: 382-386.

[14] World Bank, 2014, “ Generating Sustainable Wealth from Mozambique’s Natural Resource Boom”

done during appraisal of the Mozambique Social Protection Project (Report No: 73608-MZ). The PASP program, according to these simulations, could reach 400,000 households in the poorest 100 districts and could reduce poverty by 13 percentage points over 4 years in the affected districts. The reduction would be even more pronounced (24 percentage points) if assistance was targeted at the 40 poorest districts. The extent to which the programs reduce poverty will depend on aspects of program implementation, including targeting, as well as the size of the program that is ultimately implemented. Improved systems (for payments, targeting) will increase the effectiveness not only of the PASP program but of the other programs in the Government's National Strategy for Basic Social Security.

77. **Efforts to improve public investment management will not have a detrimental impact on poverty or social outcomes (prior action 7).** Public investment management capacity of many implementing agencies remains weak. The quality of public infrastructure has a major impact on firm competitiveness and on the distribution of returns to economic growth. The quality of public investment, as measured by the adequacy of project selection and implementation, determine to what extent increased public investment will lead to higher growth[15]. Reforms supported by the PRSC series will contribute to better appraisal and evaluation of investment projects, including social impact assessments and an identification of potential beneficiaries.

78. **Improved debt and fiscal risks management (prior actions 8 and 9) will contribute to fiscal stability and in turn to the Government's ability to continue providing public goods and services.** Improved debt and fiscal risks management will improve the Government's ability to maintain macroeconomic and fiscal stability. Debt crises have often led to macroeconomic instability that hurts the poor. Macroeconomic and fiscal instability can lead to lower (or negative) growth, higher inflation and cuts in public spending when the country needs to adjust – all with potentially negative effects on the poor.

5.2 ENVIRONMENTAL ASPECTS

79. **The legal framework for environmental protection is relatively well developed in Mozambique, but implementation and enforcement capacity remains limited.** The Law on the Environment (Law n° 20/97) is the basis for environmental regulations and applies to all public and private activities with potentially significant environmental consequences. These activities are subject to an Environmental Impact Assessment, which must precede any issuing of licenses or the approval of any new projects. A new National Environmental Quality Agency (*Agencia de Qualidade Ambiental*) in the Ministry for Land, Environment and Rural Development (*Ministério para a Terra, Ambiente e Desenvolvimento Rural*) is the agency responsible for conducting environmental assessments at the national level. This new agency has been established to provide the impact assessment function with more independence. EIA regulations are being strengthened with the ongoing revision of Decree 45/2004.

[15] Difficulties in measuring the quality of public investment remain an important caveat in studies on the relationship between investment and growth. See: Gupta, Sanjeev, Alvar Kangur, Chris Papageorgiou and Abdoul Wane (2011) "Efficiency Adjusted Public Capital and Growth", IMF Working Paper 11/217; and Rajaram, Anand, Tuan Minh Le, Nataliya Biletska and Jim Brumby, (2010) "A Diagnostic Framework for Assessing Public Investment Management", World Bank Policy Research Working Paper 5397.

80. **The revised legislation for mining and petroleum sectors makes environmental impact assessments mandatory, refers to existing norms and legislation for environmental protection and includes provision for environmental management and the end of operations.** The capacity of the Government, however, is limited due to financial and technical capacity constraints. Particular problems are the bottlenecks caused by a small number of staff being responsible for approximately 200 potentially controversial Category A projects each year. A broad-based approach to strengthen EIA capacity at the national level will be needed.

81. **The reforms supported by this PRSC series are not likely to have significant negative effects on the environment, forests, fisheries, wildlife habitats or other natural resources.** The PRSC series supports policy actions designed to accelerate poverty reduction, which by themselves have no direct impact on the environment. Regular private and public investment activities which may result from a more enabling business climate could have an impact on the environment, but as mentioned above the domestic legal framework and regulatory mechanisms are judged to be fundamentally adequate to address them. Mozambican legislation requires that such effects would have to be identified as part of the preparation of the individual business projects, with credible evidence provided as to how the developer plans to manage potential environmental consequences.

82. **The Bank, through its operations and technical assistance, is contributing to an improved management of potential environmental impact of investments.** Improved public investment management will contribute to early identification and evaluation of any environmental impact of projects before approval. The Manual for the Appraisal and Evaluation of Public Projects adopted by the former Ministry of Planning and Development (now integrated into the Ministry of Economy and Finance, MEF) to guide project appraisal and evaluation requests that social and environmental impact analyses be made as part of the project preparation process. Through MAGTAP the Bank is working to enhance the environmental and social management of extractive industries. This will include (a) carrying out strategic environmental and social assessments for the mining and gas sectors (underway since February 2015); (b) supporting the continued elaboration of sector regulations and provisions for redressing social and environmental damage; (c) increasing Mozambique's capacity to undertake economic and social impact assessments and to resolve disputes involving the sector; and (d) continuously enhance mechanisms for monitoring the sector's environmental effects. The proposed PRSC series is therefore not expected to have a significant negative effect on overall environmental quality in Mozambique.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

83. **Public financial management has been improving steadily as a reflection of the Government's commitment to the reform program and the continued support of its development partners.** While weaknesses in internal controls and the limited use of external audits remain a concern, the Government continues to strengthen these systems with support from development partners. Mozambique's State Budget is published by the Government and accessible to the general public in printed form and through the website of MEF's Planning and Budget Directorate, both the proposed budget as well as that approved by the National Assembly. Quarterly budget execution reports are also published, up to 45 days after the end of the quarter. According to the most recent Open Budget Survey, the Open Budget Index for Mozambique has declined to 38 in 2015.

84. **Recent PFM assessments conducted in Mozambique confirm significant progress in improving PFM and identify areas in need of strengthening.** A recent IMF assessment[16] argues that Mozambique has made good progress with its PFM reform agenda, in particular with regards to treasury and budget management. It also argues that the reform agenda is fragmented and dominated by IT development processes. The overall reform agenda should be adjusted, moving from a focus on IT development toward a more effective use of the system for financial management and reporting. This would require a stronger management and coordination of the overall reform agenda, driven by process and institutional development reforms. Areas that will need increased focus include planning and budgeting, internal control processes, public investment management, debt and fiscal risks management. Another recent assessment by the EU Delegation[17] offers largely similar views, arguing that a continued focus on procurement and the roll-out of e-SISTAFE (*Sistema de Administração Financeira do Estado* – State Financial Administrative System) will also be needed. The Government is seeking to reinvigorate the PFM reform agenda through a forum involving key stakeholders (including donors) to coordinate PFM reforms, a stronger emphasis on process and institutional reforms, and a renewed focus on some key areas (planning and budgeting, public investment management, fiscal risks and debt management, etc.).

85. **Anti-fraud and corruption measures in Mozambique are established through various laws and regulations (including an outdated penal code; more recent anti-corruption laws; and a Defense of the Economy Law from 1982).** The Anti-Corruption Law, adopted in 2004 (Law No. 6/2004 dated June 17 and Decree No. 22/2005) and limited to corruption involving bribes, is being revised and strengthened. The Anti-Corruption Package, adopted by the Council of Ministers in July 2011, and submitted to Parliament for approval in December 2011, is yet to be approved in its entirety. Nonetheless, some important anti-corruption legislative pieces have been approved recently, including (i) Whistle-blower and Witness Protection Law, which came into effect December 13, 2012; (ii) Public Probity Law, which includes conflict of interest and asset declaration requirements; (iii) Organic Law of Prosecution Service, which allows the Anti-Corruption Agency (*Gabinete Central de Luta contra a Corrupção*) to investigate and prosecute corruption crimes, including embezzlement, illicit enrichment, and conflict of interest. The amendment of Anti-Corruption Agency competences is already in effect, but whistle-blower and witness protection legislation will take time and resources to be fully implemented. If fully implemented, then new legislation would provide Mozambique with a strong anti-corruption framework consistent with best practices.

86. **The IMF concluded a Safeguards Assessment of the Mozambique Central Bank in mid-2011, which confirmed that its control, accounting, reporting, and auditing systems are adequate and aligned with international standards.** The assessment made recommendations to further strengthen the governance structure of the BdM, notably by opening the Central Board and the Audit Board to independent experts from outside the BdM and MoF. It also recommended that the Audit Board should ensure more systematic follow-up of audit recommendations and the audit charter be subject of an external quality assurance review in accordance with international standards. The authorities are in the process of implementing the action plan that was drawn-up as a result of the safeguards assessment. In the context of the IMF PSI, the Government agreed to follow up on the recommendations of the Assessment and implement a series of related measures. The

[16] IMF, 2014, "Refocusing the Public Financial Management Strategy", IMF, Fiscal Affairs Department
[17] EU Delegation to Mozambique, 2014, "2013 PFM Annual Monitoring Report Mozambique"

Government shall ensure that the annual financial statements of the BdM are audited in accordance with international standards on auditing as promulgated by the International Federation of Accountants and are publicly available. According to the most recent IMF review, the exchange rate was slightly overvalued at the beginning of 2015[18]. Since then the currency has further depreciated, reducing the metical's overvaluation. Mozambique has a de jure and de facto floating exchange rate arrangement, being largely determined in the interbank foreign-exchange market. No assessment of fiscal performance has been conducted.

87. **The proposed credit and grant will be disbursed following standard IDA procedures for development policy lending.** The Financing will be made available upon effectiveness and disbursed as a single tranche following the submission of an acceptable withdrawal application by MEF. IDA will deposit the dollar-denominated funds into a dedicated foreign exchange account held by the BdM in Frankfurt, and the transaction will be recorded in the Government's financial management system. Within two working days the BdM will credit the equivalent in *meticais* to the Transit Account of MEF. These funds will then be transferred from the dedicated account to the Single Treasury Account and will be used as state budget revenue and recorded as such in the public accounts. The Borrower will report to IDA on amounts deposited in the foreign exchange account and transferred to the Single Treasury Account. Budget support donors and the Government conduct a yearly flow of funds audit on budget support. As on previous occasions, the auditor's opinion on the flow of budget support funds provided during 2014 was unqualified.

88. **Disbursements from the Single Treasury Account by the Government shall not be tied to any specific purchases and no special procurement requirement shall be needed.** Proceeds from the Financing shall not be used to finance expenditures on the prohibited list defined in Schedule 1 of the Financing Agreement. If any portion of the Financing is used to finance ineligible expenditures, IDA shall require the Government to refund an amount equal to the amount of the said payment to IDA promptly upon notice. Amounts refunded to IDA under such circumstances shall be cancelled from the Financing. IDA will reserve the right to request an audit should it determine that circumstances warrant it. Should an audit be requested, a legally registered, private and independent audit company meeting appropriate international standards will be contracted to perform it, and in accordance with the Terms of Reference to be agreed upon with the Government, all audit costs will be borne by the Government. Government accounts are audited by the Administrative Tribunal. The audited General State Accounts (*Conta Geral do Estado - CGE*) are sent to parliament for discussion and published. In the past there has been limited management response to audit recommendations. The Government began developing a database in an effort to improve monitoring of the implementation of audit recommendations by public institutions in 2009 and internal control units have increased resources allocated for follow-up of recommendations in their audit work plans. Audit follow up is an integral part of the dialogue between the Government and budget support donors, and as a result of all these efforts, there has been significant progress in follow up of audit recommendations in the past few years. A copy of the CGE shall be provided to IDA within one month after the lapsed period.

[18] IMF Country Report No. 15/223

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

89. **The design of the proposed PRSC is aligned with the General Budget Support Program of budget support donors group in Mozambique.** In order to reduce the administrative burden on the Government, the Bank executes its supervisory role in cooperation with the Government's other development partners. In addition to two joint annual reviews, the implementation of the Government's program is monitored through monthly joint steering committee meetings held by the Government and budget support donors. Progress in each sector is overseen by sector working groups, which include representatives of the Government and its development partners. Bank staff actively participate in these meetings. In addition, the Bank participates in IMF missions to monitor progress on the implementation of the macroeconomic framework. Monitoring national poverty indicators is the responsibility of MEF and INE. INE is currently implementing the next round of the Living Standards Measurement Survey (the last round dates back to 2008/09), and first results are expected toward the beginning of 2016.

90. **Progress on PRSC indicators will be primarily monitored and evaluated through a set of instruments used by the National Planning System.** This includes the annual monitoring of activities and indicator targets through the Economic and Social Plan Evaluation and the Budget Execution Report as well as the joint review mechanism between government and budget support partners. M&E mechanisms are participatory, involving not only the Government and its development partners but also representatives of civil society and the private sector. Broad stakeholder participation will be achieved through a number of collaborative forums, including the annual review process and planning meetings based on the strategic matrix for budget support of the PQG. In addition, M&E mechanisms for specific indicators related to social protection and private sector development will be encompassed under the World Bank's Social Protection Program and the IFC's Investment Climate Program.

91. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS**.** For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND RISK MITIGATION

92. **The risk to this operation is moderate. The principal risks to the objectives of this operation include macroeconomic shocks, institutional capacity constraints, political uncertainty with the change in administration, and vulnerability to natural disasters.** These risks are presented below.

93. **Mozambique's macroeconomic stance could be negatively affected by worsening current account deficits, rising external debt, or unpredictable external shocks such as commodity price and demand shocks. Macroeconomic risks are considered moderate.** Sustainable internal and external macroeconomic balances depend on anticipated inflows of FDI, as well as external debt conditions and continued foreign assistance. Low commodity prices and a weak external environment increase the risks to the macroeconomic outlook, but the risks to the achievement of the operation's development objective are considered moderate. Weak commodity prices may affect investors' interest in Mozambique's natural resources, as can already be observed in the coal sector. Limited investor interest may affect the results expected in the first pillar regarding new contracts being signed under the revised regulatory framework for mining and petroleum. All other results are unlikely to be affected by macroeconomic instability (other than tail events which are unlikely). To mitigate macroeconomic risks, the National Assembly approved a 2015 budget that puts the country back on a sustainable path by significantly reducing public spending and narrowing the deficit. The 2016 draft budget prepared by the Government continues with a prudent fiscal policy, although further fiscal tightening may be needed if balance of payments pressures continue.

94. **Weak institutional capacity may slow the implementation of reforms. Institutional capacity risks are considered substantial.** Despite ongoing improvements in the capacity of the public administration, a lack of institutional resources could limit the pace and scope of the reforms supported by the proposed PRSC-11. Institutional changes in the new government (the merger of MPD and MoF into a single ministry) may also delay the pace of important reforms as key counterparts move to different agencies. To mitigate this risk the Bank is providing technical assistance in all areas supported by this operation, seeking to fill the lack of institutional resources. The Bank is also trying to work with a wider number of stakeholders to minimize the risk of key counterparts moving. Despite this support, institutional capacity risks are regarded as substantial.

95. **The inauguration of a new Government after the general elections in October 2014 could delay the pace of the reform program**. **Political risks are considered moderate.** The political climate in the two years prior to the election was characterized by significant tensions between ruling party *Frente de Libertação de Moçambique* and opposition party RENAMO. These tensions led to violent confrontations between the army and RENAMO-backed guerrillas in the country's central region in 2013 and 2014. Political dialogue between the ruling party and the opposition has resulted in mutually agreed-upon revisions to election legislation and a cease-fire agreement, declaring the end of the violent confrontations. However, there are continued confrontations on a number of fronts. The start of a new administration could affect the pace of reforms, although there is significant policy continuity, as evidenced by the new PQG and continued engagement with development partners to gain support to the Government's economic reforms program. The likelihood of major policy reversals with this Government is therefore limited and political risks to the achievement of results are moderate.

96. **Finally, Mozambique's inherent vulnerability to natural disasters and weather-related shocks represents a moderate and indirect risk to this operation. Natural disasters and weather related shocks are considered moderate.** Mozambique is the only country in Africa considered to be at high risk from recurrent floods, cyclones and droughts. In the past 30 years, at least 14 percent of the population has been affected by a drought or flood/storm. Natural disasters present serious threats to public health, food security, and the Government's poverty reduction and human development goals since they tend to disproportionately affect the poor and vulnerable. The

immediate necessity of responding to environmental shocks could draw scarce administrative resources away from the reform program and threaten its long-term continuity. The floods in early 2013 and early 2015 again highlighted the relatively large impact that natural disasters can have on the country's fiscal position and economic growth prospects. Large natural disasters could also lower returns to both public and private investment. The risk of major disruptions due to natural disasters and weather related shocks is mitigated by the Government's commitment to rapidly implementing many key policies supported by the proposed PRSC, while the ongoing dialogue on enhancing resilience to natural disasters is supported by the concurrent Climate Change DPO series. Emerging economic activity by mining industries is taking place in less vulnerable zones of the interior, with the potential to influence positively the risk exposure of the landscape. Coupling the benefits of risk based urban planning with expected increases in household incomes, the vulnerability of communities is expected to decrease.

Table 8: Mozambique – The Systematic Operational Risks-rating Tool (SORT)

Risk categories	**Rating (H, S, M or L)**
1. Political and governance	**M**
2. Macroeconomic	**M**
3. Sector strategies and policies	**M**
4. Technical design of project or program	**M**
5. Institutional capacity for implementation and sustainability	**S**
6. Fiduciary	**M**
7. Environmental and social	**L**
8. Stakeholders	**L**
9. Other	
Overall	**M**

ANNEXES

ANNEX 1: POLICY MATRIX AND RESULTS FRAMEWORK
Eleventh Poverty Reduction Support Development Policy Financing (PRSC-11) - Mozambique

Outcomes sought in line with CPS Outcomes	PRSC9 Prior actions	PRSC10 Prior actions	PRSC 11 Prior actions	Indicator	Baseline 2011	End Program Target (2016)
Pillar 1: Improve business regulations and investment climate and increase transparency in the management of extractive industries						
Improving Business Regulations and Investment Climate.	The Council of Ministers has approved the Commercial Licensing Decree.	The Council of Ministers has approved the Industrial Licensing Decree.		Number of days needed to obtain a business license.	15 days to obtain a Commercial License. 40 days to obtain an Industrial License.	8 days to obtain a Commercial License. 20 days to obtain an Industrial License.
		The Council of Ministers has adopted a single form for opening a new business and start activities.	The Ministry of Trade and Industry has introduced the e-*BAU* to further streamline business start-up procedures	Number of days needed to start a business.	13 days needed to start a business.	8 days needed to start a business.
Improving transparency and management in extractive industries.	Mozambique has achieved compliance with the standards of the Extractive Industries Transparency Initiative (EITI).		The Recipient has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative	Number of applied EITI principles and criteria.	0	Mozambique remains a compliant member of EITI with further improvements in transparency and has published the reconciliation reports up to 2014 in the Government's public portal in line with the new and revised EITI guidelines.
	The Council of Ministers has approved the draft Mining Law and has sent it to its National Assembly for approval.		The Council of Ministers has approved the implementing regulations for Law No. 20/2014 dated 18 August 2014 published in the *Boletim da República* No. 66	New mining contracts negotiated under the revised legislative framework.	0	All new mining contracts starting 2015 will be negotiated under the revised legislative framework

Outcomes sought in line with CPS Outcomes	PRSC9 Prior actions	PRSC10 Prior actions	PRSC 11 Prior actions	Indicator	Baseline 2011	End Program Target (2016)
			Serie I on 18 August 2014 (the Mining Law)			
	The Council of Ministers has approved the draft Hydrocarbons Sector Law and has sent it to its National Assembly for approval.	The Council of Ministers has approved the bill defining the fiscal regime for the hydrocarbon sector and has submitted the bill to its National Assembly for approval.	The Council of Ministers has approved the implementing regulations for Law No. 21/2014 dated 18 August 2014 published in the *Boletim da República* No. 66 Serie I on 18 August 2014 (the Hydrocarbon Law)	New gas contracts negotiated under the revised legislative framework.	0	All new petroleum contracts starting 2015 will be negotiated under the revised framework
	The State Budget for 2013 has allocated 2.75 percent of revenues generated by extractive industries to districts for infrastructure development of communities in which the extractive industries operate.		The Ministry of Economy and Finance (MEF) has revised the system by which it transfers a share of the production taxes generated by mining and petroleum projects to communities in affected areas by budgeting a share of the royalties collected during calendar year 2014	Percentage of transfers to communities that are executed by communities.	0%	80%
Pillar 2: Strengthen Social Protection						
Improving Access and Allocation of Social Protection Systems.		The National Institute of Social Action (INAS) has developed and adopted a single registry of beneficiaries for all INAS programs providing cash to beneficiaries.	INAS has registered 50% of PASP beneficiaries in the single registry of beneficiaries	Share of the benefits of the PASP transfers to those above the US$1.25 poverty line	10%	2%

Outcomes sought in line with CPS Outcomes	PRSC9 Prior actions	PRSC10 Prior actions	PRSC 11 Prior actions	Indicator	Baseline 2011	End Program Target (2016)
	The Council of Ministers has approved the PASP which was scaled-up in the 2013 State Budget to increase the number of beneficiaries.			Total number of direct public works program (PASP) beneficiaries.	0	At least 20,000 direct beneficiaries from the PASP.
	The Coordinating Council of the System of Basic Social Security has authorized INAS to outsource the payment of cash benefits for its social safety net programs.	INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the payment distribution system.		Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due.	0%	Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due reaches 50 percent.
Pillar 3: Enhance Public Finance Management						
Improving the management of audits, public investment and public debt.	The Ministry of Finance has developed a systematized database which contains the recommendations for, and the current status of, its implementation, thus allowing effective follow-up so that 20 percent of IGF and OCI audit recommendations were implemented.			Percentage of recommendations implemented by the entities audited/inspected by the OCI's and IGF	Less than 15 percent of audit recommendations by OCI and IGF are implemented by the entities audited/inspected.	At least 40 percent of the audit recommendations by OCI and IGF are implemented by the entities audited/inspected
	The Ministry of Planning and Development has adopted the Manual for the Appraisal and Evaluation of Public Projects.	The Ministry of Planning and Development and the Ministry of Finance have issued a revised methodology for the elaboration of the medium-term fiscal framework making appraisal of public	MEF has mandated that all projects above fifty million United States Dollars (50,000,000) be submitted to MEF including a viability study	Percent of public investment that has been developed as projects, appraised and evaluated,	0%	All public investment projects included in the Integrated Investment Program have been appraised and evaluated, including an analysis of returns to investment that informs fiscal policy.

Outcomes sought in line with CPS Outcomes	PRSC9 Prior actions	PRSC10 Prior actions	PRSC 11 Prior actions	Indicator	Baseline 2011	End Program Target (2016)
		investments mandatory for all projects in excess of USD5 million equivalent.		following the guidelines adopted for project appraisal and evaluation.		
		The Council of Ministers has adopted the *Programa Integrado de Investimentos 2014-2017*.				
	The Council of Ministers has approved the Medium Term Debt Management Strategy (2012-2015).	The Ministry of Finance has implemented the first annual domestic borrowing plan, prepared based on the medium term debt management strategy.	MEF has prepared the Recipient's medium term debt management strategy for 2015-2018	Quarterly and yearly debt reports published.	Debt reports only published on an annual basis.	Quarterly public debt reports are prepared for the 2013 and 2014 fiscal years and are published in the Government's public portal; they include information on costs and risks of the debt portfolio. The Government adheres to the annual domestic borrowing plans issued by issuing within 25% higher/ lower of the planned amount.
		The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012).	MEF has created a fiscal risks department within its Directorate for Financial and Economic Studies to better manage fiscal risks	Fiscal risk statement in the budged.	Budget documentation does not include any information on fiscal risks.	The 2017 budget incorporates detailed information and quantification on fiscal risks.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

REPÚBLICA DE MOÇAMBIQUE
MINISTÉRIO DA ECONOMIA E FINANÇAS
GABINETE DO MINISTRO

Ref. n 346 /GM/MEF/2015
Maputo, November 4, 2015

Subject: Letter of Development Policy for the Eleventh Poverty Reduction Support Credit (PRSC 11)

1. I am writing on behalf of the Government of the Republic of Mozambique to request the Eleventh Poverty Reduction Support Credit (PRSC 11) in the amount of US$ 70 million from the International Development Association (IDA), to support the implementation of the country's Action Plan for Poverty Reduction (PARP 2011 - 2015), which was endorsed by the Council of Ministers in 2011.

2. After successful democratic elections conducted in October 2014, His Excellency Filipe Jacinto Nyusi was sworn in as a new President, and a new Government was inaugurated in January 2015. A Five Year Government Plan 2015 -2019 (Plano Quinquenal do Governo 2015-19) was approved by the Parliament in April 2015.

3. We would like to commend the Word Bank's commitment to support our efforts to reduce poverty over the years and the active participation in the budget support partners to Mozambique, and signatory of the new Memorandum of Understanding between the Government of Mozambique and the budget support development partners signed in 2015.

4. The Five Yeas Government Plan 2015-19 (PQG 2015-19) has employment promotion, productivity and competitiveness an overarching theme to achieve more inclusive growth. The PQG 2015-19 has five priorities: (i) consolidate national unity, peace and sovereignty, (ii) human and social capital development, (iii) promote employment and improve productivity and competitiveness, (iv) economic and social infrastructure development and (v) ensure sustainable and transparent management of natural and environmental resources. It also has

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three supporting pillars which are (a) consolidate the democratic rule of law, good governance and decentralization, (b) promote a balanced and sustainable macroeconomic environment and (c) reinforce international cooperation. We are working with budget support development partners to develop a results framework for budget support that is aligned with the PQG 2015-19 so that budget support is in line with the country's priorities. Departing from past practice, and in agreement with development partners, we will not be preparing a poverty reduction strategy paper. This will contribute to a streamlining and consolidation of government planning instruments. This is in line with the objectives of this operation, which is to support government efforts to improve the business environment, strengthen social protection and enhance public finance management.

Macroeconomic context and outlook

5. *Mozambique's economy remains robust, with growth estimated at 7.2 percent in 2014, supported by growth in the financial sector (7,6%), agriculture(3,1%) and trade(5,2%). Extractive industries continue to be a very dynamic sector, but growth has slowed down as a result of low commodity prices and infrastructure constraints. We expect developments in the mining and petroleum sectors to transform Mozambique's economy in the medium term, resulting in strong growth in coal production and exports, the implementation of large infrastructure investments, including LNG plants and greater dynamism in thle construction and transport sectors.*

6. *In line with developments around the world, growth in 2015 has decelerated, with growth in the first half of 2015 reaching 6.3 percent compared to 6.9 percent in the first half of 2014. The most dynamic sectors in the first half of 2015 were extractive industries (17, 3%), construction (10,6%), fisheries(11,0%), and electricity, gas and water(13,2%),. We expect growth in 2015 to be 7 percent and to accelerate to around 8 percent in the medium term, as investments in the extractive industries and related sectors (construction, trade, transport) pick up and growth in some of the traditional sectors such as agriculture recovers.*

7. *Year on year inflation at the end of 2014 was 1.1 percent, well below BdM's target of 5-6 percent. Inflation remains low but has accelerated, reaching 2.41 (year-on-year) by September 2015. Low inflation was supported by low commodity prices and relative stability against the South African Rand, while the Metical has depreciated significantly against the US$ over the past year. After several years*

of monetary easing, the central bank increased policy rates by 25 bps to 7.75 in October 2015. We expect inflation between 5 and 6 percent over the next few years and we will continue to monitor inflation and proactively coordinate fiscal and monetary policies. Monetary policy will remain oriented toward achieving the objectives of keeping inflation low and stable, safeguarding the financial system and encouraging lending. We will continue reforms to improve operations in the financial system and broaden access to financial services.

8. *In 2015 we have started a process of fiscal consolidation. Spending as a share of GDP will decline by almost 7 percentage points of GDP to around 35 percent of GDP, narrowing the (after grants) deficit from 10.1 percent of GDP to a projected 6 percent of GDP.. We continue to allocate a significant share of our resources to close the infrastructure gap in the country, although capital expenditures will decline to around 13 percent of GDP. We will continue to implement a prudent fiscal policy in the medium term, with further declines in expenditure levels that, together with increased revenue, will contribute to a narrowing of the fiscal deficit. These efforts will ensure that the country maintains fiscal and macroeconomic stability.*

9. *Over the past few years we have seen a widening of the current account deficit, caused by significant FDI inflows for the extractive industries, which by nature are capital- and import intensive. The current account deficit widened to US$5.8 billion in 2014 or 34 percent of GDP. We expect the deficit to narrow in 2015 on account of a reduction in investment in the coal and gas sectors. Investments will pick up again in the second half of 2016 and onwards, with the current account deficit widening again as the construction phase of the LNG development in the north of the country starts. We expect the current account deficit to quickly narrow toward the end of the decade when gas exports will start. Low commodity prices and lower than expected FDI inflows have put pressure on the metical in the last year, which has depreciated against the US$ from around 30 Mts/US$ in mid-2014 to 42 Mts/US$ by end of August 2015. This level of depreciation against the US$ is not dissimilar with that observed in many other countries in Africa. International reserves have declined from US$3.2 billion in August 2014 to US$2.3 billion by end September 2015..*

10. *The depreciation of the metical has increased our debt service as a share of GDP, since a large share of it is denominated in US$. A Debt Sustainability Analysis has been prepared with the support of the World Bank and the IMF shows that the present value of the debt to GDP ratio has reached 40 percent but the risk of*

debt distress continues to be considered moderate. We will continue to conduct a prudent fiscal policy to moderate borrowing and reduce debt from current levels and we will continue to work with your institution to improve debt management. As part of our efforts to improve fiscal management, we continue to work together with the World Bank and other development partners to enhance the way we manage fiscal risks, and a number of those reforms are supported by this operation.

Implementation of the Poverty Reduction Strategy

11. *We are committed to sustain our pursuit of more inclusive growth during and beyond the current Action Plan for Poverty Reduction. During the past year, the following results were achieved as part of our poverty reduction strategy and the support provided by budget support development partners:*

    a. *Enhancing production and productivity in agriculture. Agriculture employs 78 percent of the economically active population and contributes 26 percent to GDP. Productivity increases and the expansion of areas under cultivation are key to improvements in the livelihood of the population. To this end, we have adopted an agricultural sector development strategy (PEDSA) for 2011-20 and an agricultural investment plan (PNISA) 2013-17 that will help to gradually shift production from subsistence to commercial farming. During 2014, 19% of farmers were supported by extension services, the area under rehabilitated irrigation network increased to 8,727 ha and the share of roads in good condition increased to 73%.*

    b. *Creating employment. The ability of the private sector to create productive employment will be crucial in our efforts to ensure that growth is inclusive. We have a strategy for the Improvement of the Business Environment 2013-17 (EMAN II) and are working with development partners, including the World Bank Group, to implement the interventions included in this strategy. As a result of these efforts we have continued to strengthen vocational training and improved opportunities for SMEs in public tenders, while an increasing number of jobs are being created under the simplified licensing regime.*

    c. *Enhancing social and human development. Efforts to boost primary school enrolment continued. The net school enrollment rate at age 6 in first grade increased to 82 percent, with increasing gender-equitable system,* *particularly in secondary schools. Assisted deliveries increased to 71 percent in the health sector, 433,000 households are now benefiting from social assistance programs and the number of water sources in rural areas increased to almost 25,000.*

<u>Recent and planned reforms in this operation</u>

12. *This operation will support a number of reforms in three areas that are crucial for the achievement of the development objectives outlined in the PARP and in the new PQG: (i) foster economic development, (ii) strengthen social protection and (iii) improve public finance management. The specific reforms implemented over the last year include:*

Economic Development – Investment Climate

13. *As part of our efforts to improve the business and investment climate, we have been working with the World Bank Group to simplify licensing requirements in a number of areas and streamlining procedures for starting a new business. In 2013 we revised the commercial and tourism licensing regulations which reduced the number of days that businesses need to obtain these licenses as well as the administrative costs associated with the process. In 2014 we revised the industrial licensing regulations which reduced the amount of time required to issue industrial licenses. In 2014 we also adopted a single form for opening a new business and starting activities, which cut by half the number of steps required for regulatory compliance. In the last year we established online one-stop-shops (e-BAU) to further streamline business startup procedures. Private firms are now able to submit all required information at the Government's e-BAU. This has cut the number of steps required for regulatory compliance from 9 to 5, a 44 percent reduction.*

Economic Development – Management of Extractive Industries

14. *The Government is accelerating efforts to strengthen both our systems and regulatory environment to be able to manage the country's extractive industries, which are likely to become an engine of growth and, if well managed, bring significant benefits to the population. The national assembly passed recently four crucial pieces of legislation for the management of extractive industries. The mining law and the fiscal regime for mining will govern the management of the sector and also determine the sharing of rents between investors and the public.*

The petroleum law and the fiscal regime for petroleum will do the same for the petroleum sector. In October of 2015 the Government approved the implementing regulations for the mining law and in November of 2015 the implementing regulations for the petroleum law. Both provide additional clarity and certainty to investors.

15. *We are also aiming to maximize transparency in the way the country manages extractive industries. We published the 5th EITI report complying with the new EITI standard. The majority of contracts with investors in the extractive industries were also made public online and we continue to share a portion of the production taxes paid by extractive industries with affected communities to ensure that the benefits of these industries are also felt by those closest to the large investments taking place. In 2015 we allocated 2.75 percent of production taxes to producing districts. We have revised the system by which we estimate the transfers to communities to avoid within-year volatility and allow communities to focus on implementing projects with the budgeted funds.*

Social Protection

16. *A large proportion of Mozambique's population is highly vulnerable to shocks. These include structural food insecurity during the annual agricultural cycle, unpredictable changes in food prices, and a range of natural disasters. As a way of supporting the poor and vulnerable, the Government is seeking to improve and expand its social assistance programs. Many social assistance programs are administratively or geographically fragmented, have low overall coverage, or are not well targeted. In the past few years benefits have been made more generous and the coverage of the social protection programs have been widened. As we continue to allocate additional resources to these key programs (the Basic Social Subsidy Program – PSSB, and the Productive Social Action Program – PASP), we will need to establish more effective mechanisms for selecting, recording and organizing beneficiaries in order to allocate and manage funds effectively.*

17. *.The INAS (National Institute of Social Action) has developed a single registry covering all beneficiaries of basic social assistance programs, starting with those enrolled in the PSSB, PASD and PASP. The Government, by October 2015, has already registered 50 percent of all PASP beneficiaries in the single registry and will continue with efforts to register the rest of the social program beneficiaries. We also launched a tender process in late 2014 to outsource the payments of all social protection subsidies to a private sector provider. We have canceled this*

process due to a lack of acceptable bids. We will re-launch this process shortly and in the meantime we are implementing a number of measures in the formal payment system for the beneficiaries of the PSSB and PASP programs. We remain fully committed to a payments system that ensures that cash benefits are timely, predictable and transparent.

Public Finance Management

18. *As part of our efforts to enhance the effectiveness of public expenditure, we are strengthening systems to manage public investments and continue with efforts to enhance the management of debt and fiscal risks. As the country starts to benefit from increasing revenues from extractive industries, which may grow exponentially toward the end of the decade, it is particularly important to strengthen government systems to ensure that a larger resource envelope translates into improved provision of public goods and services, laying the foundation for robust economy-wide growth.*

19. *As we continue with our efforts to close the large infrastructure gap t, we are strengthening our systems to manage public investments to ensure the implemented projects have the expected returns. As part of those efforts the Government has undertaken a number of initiatives, including: (i) adoption of the Integrated Investment Program (Programa Integrado de Investimento—PII), (ii) establishment of the Public Project Coordination and Selection Committee (Comité de Coordenação e Selecção de Projectos Públicos, CCSPP), an organ of the Ministry of Economy and Finance that advises government on the prioritization and selection of public investment projects, (iii) adopted a Manual for the Appraisal and Evaluation of Public Projects to guide project preparation and establish a standard set of criteria for assessing project proposals. With the support of the World Bank and other development partners we have also invested in building the capacity of government officials at the central and subnational level for improved preparation and evaluation of investment projects. Earlier this year we strengthened the regulatory environment by issuing a circular that mandates that all investment projects above US$50 million have to be submitted to the Ministry of Economy and Finance accompanied by a viability study.*

20. *We are also seeking to strengthen our ability to manage debt and fiscal risks, improved management of debt and fiscal risks will allow us to continue implementing our ambitious infrastructure investment plan without compromising fiscal sustainability. As part of our efforts to improve debt*

management, we formulated our first annual domestic borrowing plan in 2013 which we have successfully implemented. We have revised the Medium Term Debt Management strategy this year which will inform financing choices going forward. Recognizing the need to pay increased attention to fiscal risks management, this year we have created a fiscal risks unit in the Ministry of Economy and Finance.

Activities undertaken in 2015

21. *The PRSC-11 will support the following prior actions already completed by the Government of Mozambique to achieve results in the reform aims discussed above:*

    a) *The Government introduces the e-BAU, an integrated IT platform to further streamline business start-up procedures*
    b) *Mozambique has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative (as approved on May 2013)*
    c) *The Council of Ministers approves the implementing regulations for the Mining Law*
    d) *The Council of Ministers approves the implementing regulations for the Hydrocarbons Law*
    e) *The Government revises the system by which it transfers a share of the production taxes to communities and its use based on the experience accumulated*
    f) *INAS registers 50% of PASP in the Single Registry of Beneficiaries (SRB)*
    g) *The Ministry of Economy and Finance mandates that all projects above US$50 million have to be submitted to the Ministry of Economy and Finance accompanied by a viability study*
    h) *The Ministry of Economy and Finance prepares the Medium Term Debt Management Strategy for 2015-2018*
    i) *The Ministry of Economy and Finance creates a new Fiscal Risks Unit to better manage fiscal risks*

Conclusion

22. *To conclude, we would like to reiterate the Government's commitment towards promoting inclusive growth and poverty alleviating, as demonstrated by the reforms being implemented and supported by this operation. In this context, the*

Government hopes IDA will approve the requested PRSC-11 to support recent reforms which seek to improve the business climate and increase transparency in the management of extractive industries, strengthen social protection and enhance public finance management.

With highest consideration,

Yours Sincerely,
Adriano Afonso Maleiane

Minister of Economy and Finance
And Governor for Mozambique

To:
Mr. Jim Yong Kim
President
The World Bank Group
Washington D.C.

Cc: ***H.E. Ernesto Gouveia Gove***
Governor of Bank of Mozambique

ANNEX 3: IMF RELATIONS NOTE

IMF Holds Discussions on the 5th Review under the PSI, on a New SCF Arrangement, and on the 2015 Article IV Consultation with Mozambique

Press Release No. 15/488

October 29, 2015

A staff team from the International Monetary Fund, led by Michel Lazare, visited Mozambique during October 14-28, 2015 to complete discussions towards the completion of the fifth review under the three-year Policy Support Instrument (PSI) approved in June 2013 (see Press Release No. 13/231) and under the 2015 Article IV Consultation, and reach understandings on a new program to be supported under the IMF's Stand-by Credit Facility (SCF).

The team met with Prime Minister Carlos Agostinho do Rosario, Economy and Finance Minister Adriano Maleiane, Bank of Mozambique Governor Ernesto Gove, and other sectoral ministers, senior government officials, the private sector, civil society, and development partners.

At the conclusion of the visit, Mr. Lazare issued the following statement:

"The Mozambican authorities and the IMF team completed the Article IV Consultation discussions and reached a staff-level agreement for completing the fifth review under the PSI-supported program. In addition, they have reached a staff-level agreement on an 18-month economic framework through 2017 that could be supported with SDR 204.48 million (about US$286 million) under the IMF's SCF, subject to approval by IMF management and the Executive Board. The Executive Board meeting is tentatively scheduled for mid-December 2015.

"Economic activity in 2015 has remained solid, though new challenges have emerged and require decisive policy action. In the mission's views, growth will reach 6.3 percent in 2015 and is projected to accelerate slightly to 6.5 percent in 2016. Inflation is currently still low at about 2 percent, but is expected to increase towards 5-6 percent over the next few months due to the recent depreciation of the metical, and required adjustments in administered prices. Over the medium term (2017-20), growth could average 8 percent owing to positive prospects of massive investments in extractive industries, especially liquefied natural gas.

"While medium-term prospects remain positive, short-term challenges have become more complex. As other countries in the region, Mozambique is currently experiencing an external shock associated with the drop in commodity prices, lower growth in trading partners, and delays in investment associated with large natural resource projects. Excessively expansionary policies in 2014 (especially on the fiscal side) also contributed to the current difficulties the country is facing. Imports have continued to grow at a fast pace at 17 percent year-on-year, while exports have stagnated. Capital inflows have also declined substantially compared to a year ago. This has created pressures in the foreign exchange market and has caused a sharp decline in international reserves and a depreciation of the metical.

“Against this backdrop, performance in implementing the IMF-supported PSI program was mixed. While some end-June 2015 quantitative program targets were met, 3 assessment criteria and one indicative quantitative target were missed. The same criteria and target were also missed at the end of September 2015. Delays were also incurred in the implementation of a number of structural reforms supported under the PSI.

“Subject to approval by the IMF management and the Executive Board, the team and the authorities agreed on a strong corrective policy package to put the program back on track and manage the above mentioned shocks to the balance of payments. This policy package would involve further fiscal consolidation in 2016 to continue to preserve debt sustainability and contribute to the needed external adjustment. Monetary policy tightening and substantial moderation in credit expansion is also required. The team commended the Bank of Mozambique for the recent decision to tighten monetary policy and recommended a continuation of the tightening cycle. In addition, efforts to reduce the current fragmentation of the foreign exchange market are necessary to generate greater incentives for banks to mobilize foreign exchange from their depositors. The team also discussed a range of structural reforms to help manage fiscal risks, eliminate arrears on VAT refunds, make public spending more efficient and transparent, and support more inclusive growth, including through greater financial deepening.

“The team believes that the authorities’ economic program, together with the agreed policy package, is strong and adequate to respond to the temporary external shocks that the Mozambique economy is going through at the moment.

“We would like to thank the authorities for the constructive policy discussions and warm hospitality.”

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