

**Document of  
The World Bank**

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Report No. 90299-MZ

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED CREDIT  
IN THE AMOUNT OF SDR 37.3 MILLION  
(US\$55 MILLION EQUIVALENT)

AND A PROPOSED GRANT  
IN THE AMOUNT OF SDR 37.3 MILLION  
(US\$55 MILLION EQUIVALENT)

TO

THE REPUBLIC OF MOZAMBIQUE

FOR THE

TENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING

November 10, 2014

Macroeconomics and Fiscal Management  
Global Practice  
Africa Region

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## MOZAMBIQUE - GOVERNMENT FISCAL YEAR

January, 1 – December 31

### CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 6, 2014)

Currency Unit	=	New Metical (MZN)
US\$1	=	MZM 30.90
MZM1	=	US\$ 0.03236
US\$1	=	SDR 0.67644

### WEIGHTS AND MEASURES

Metric System

### ABBREVIATIONS AND ACRONYMS

BdM	Central Bank of Mozambique ( <i>Banco de Moçambique</i> )
CCSPP	Comité de Coordenação e Selecção de Projectos Públicos
CGDP	Comité de Gestão da Dívida Pública
CGE	Conta Geral do Estado
CPS	Country Partnership Strategy
CUT	<i>Conta Única do Tesouro</i>
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
EITI	Extractive Industries Transparency Initiative
EMATUM	Empresa Moçambicana de Atum
ENSSB	Estratégia Nacional de Segurança Básica
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 ( <i>Inspecção Geral de Finanças</i> )
IMF	International Monetary Fund
INAS	National Institute of Social Action ( <i>Instituto Nacional de Acção Social</i> )
INE	National Statistical Institute ( <i>Instituto Nacional de Estatística</i> )
LNG	Liquefied Natural Gas
MAGTAP	Mining and Gas Technical Assistance Project
MICOA	Ministério para a Coordenação de Acção Ambiental
MoF	Ministry of Finance ( <i>Ministério das Finanças</i> )
MoU	Memorandum of Understanding

MOZAL	Mozambique Aluminium Company
MPD	Ministry of Planning and Development ( <i>Ministério do Planificação e Desenvolvimento</i> )
MSME	Micro, Small and Medium Enterprises
NCB	Non-concessional borrowing
OCI	Internal Control Units ( <i>Órgãos de Control Interno</i> )
OE	Orçamento do Estado
PAF	Performance Assessment Framework
PARP	Action Plan for the Reduction of Poverty ( <i>Programa de Acção para a Redução da Pobreza</i> )
PASD	Direct Social Action Program ( <i>Programa de Apoio Social Directo</i> )
PASP	Productive Social Action Program ( <i>Programa de Acção Social Productiva</i> )
PER	Public Expenditure Review
PES	Economic and Social Plan ( <i>Plano Económico e Social</i> )
PFM	Public Financial Management
PII	Plano Integrado de Investimento
PIM	Public Investment Management
PQG	Plano Quinquenal do Governo
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
PSSB	Basic Social Subsidy Program ( <i>Programa de Subsidio Social Básico</i> )
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

### TENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING

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**CREDIT AND PROGRAM SUMMARY**  
**THE REPUBLIC OF MOZAMBIQUE**  
**TENTH POVERTY REDUCTION SUPPORT DEVELOPMENT POLICY FINANCING**

Borrower	The Republic of Mozambique
Implementing Agency	Ministry of Planning and Development
Financing data	50 percent IDA Credit and 50 percent IDA Grant. Currency is US\$. Amount: SDR 74.6 million (US\$110 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 second 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 Program Development Objectives	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	<p><i>Policy Area (i): Improve the business regulations and investment climate and increase transparency in management of extractive industries</i></p> <ol style="list-style-type: none"> <li>1. Number of days needed to obtain a business license. Commercial license: From 15 to 7 days, industrial license from 40 to 20 days.</li> <li>2. Number of days required to start a business: From 13 to 8 days.</li> <li>3. Number of applied EITI principles and criteria. Baseline: No compliance. Target: Mozambique remains compliant with EITI and publishes reconciliation reports up to 2014 in line with the new and revised EITI guidelines.</li> <li>4. New mining contracts negotiated under the revised legislative framework. From zero to 2.</li> <li>5. New gas contracts negotiated under the revised legislative framework. From zero to 2.</li> <li>6. Percentage of transfers to communities that are executed by communities. From 0% to 80%.</li> </ol> <p><i>Policy Area (ii): Strengthen Social Protection</i></p> <ol style="list-style-type: none"> <li>7. Percentage of beneficiaries registered in the Single Registry of Beneficiaries. Baseline: Zero. Target: INAS uses a single registry for beneficiaries of the three main Social Protection Programs: PSSB, PASD and PASP.</li> <li>8. Total number of direct public works program (PASP) beneficiaries. From zero to at least 20,000 direct beneficiaries from the PASP.</li> <li>9. Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due. From zero to 50%.</li> </ol> <p><i>Policy Area (iii): Enhance Public Finance Management</i></p> <ol style="list-style-type: none"> <li>10. Percentage of recommendations implemented by the entities audited/ inspected by the OCI's and IGF. From less than 15% to at least 40%.</li> <li>11. Percentage of public investment that has been developed as projects, appraised and evaluated, following the guidelines adopted for project appraisal and evaluation. Baseline: Zero. Target: All public investment projects included in the Integrated Investment Program, including an analysis of returns to investment that informs fiscal policy.</li> <li>12. 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 adheres to the annual domestic borrowing plans issued.</li> <li>13. 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 2016 budget.</li> </ol>
Overall risk rating	Moderate.
Project ID	P146537

**INTERNATIONAL DEVELOPMENT ASSOCIATION  
PROGRAM DOCUMENT  
FOR THE TENTH POVERTY REDUCTION SUPPORT  
DEVELOPMENT POLICY FINANCING (PRSC)  
TO THE REPUBLIC OF MOZAMBIQUE**

**1. INTRODUCTION AND COUNTRY CONTEXT**

1. **This program document proposes the Tenth Poverty Reduction Support Development Policy Financing (PRSC-10) to the Republic of Mozambique that is aligned with the strategic objectives of the Action Plan for the Reduction of Poverty (PARP)** and is an integral part of the Bank’s strategy to support the Government’s PARP. The proposed operation would be the second of three annual single-tranche operations to be delivered over FY13-16. This program document proposes a set of prior actions for the PRSC-10 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 7.4 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<sup>1</sup>. From 1993 to 2008, the major driver behind growth was capital accumulation, accounting for almost 50 percent of all growth. Investments by megaprojects and improvement in education led to significant accumulation of human (quality-adjusted) as well as physical capital. The contribution of capital accumulation to growth increased after 1998, with a significantly smaller role for Total Factor Productivity (TFP) contribution to growth in the latter years. Mining, electricity and other services have led the expansion, and in recent years growth has been driven by Foreign Direct Investment (FDI) inflows in extractive industries. Major discoveries of coal and gas may transform Mozambique into a significant player in global markets, but in order to reap the benefits of a growing resource sector the Government will need to develop the capacity to manage the country’s extractive industries and ensure that they contribute to sustainable and broad-based growth.

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<sup>1</sup> World Bank, 2012, “Mozambique - Reshaping Growth and Creating Jobs through Trade and Regional Integration - Country Economic Memorandum”, Report No. 59356-MZ.

**4. Over the past decade rapid growth has not translated into significant poverty reduction.** Strong economic growth was accompanied by large decreases in poverty until the early 2000s. The national poverty headcount fell by 14 percentage points between 1997 and 2003 to 56 percent, while income per capita<sup>2</sup> grew by 36 percent during the same period, a growth elasticity of poverty reduction of 0.4. Poverty fell between 2003 and 2009 to 52 percent, a much slower rate of decline, implying a growth elasticity of poverty reduction of only 0.1. The weakened relationship between growth and poverty reduction is due to the changing pattern of growth, which in the past decade was driven by 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. The reforms supported by this operation will contribute to a more inclusive growth pattern that reverses the weakening relationship between growth and poverty reduction.

**5. The geographical distribution of poverty remains largely unchanged, with both moderate and extreme poverty concentrated in rural areas and in the Central and Northern regions.** Regional differences have increased over time, as 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, especially the Maputo area. Nationwide, rural poverty continues to be severe and pervasive. What rural poverty reduction has occurred has been concentrated in the southern provinces, reflecting spillover effects from the rapid growth of urban centers in the region. Elsewhere in the country rural poverty rates remain unchanged, and in Central Mozambique the poverty headcount actually increased between 2003 and 2009. The Government's official statistics present a different picture, due to methodological differences<sup>3</sup>. Official statistics place the poverty rate in both 2003 and 2009 at about 54 percent. The distribution of poverty in the official statistics differs from the figures presented here, with poverty lowest in the rural north and Maputo city, while poverty is highest in the south of the country. The Bank is providing technical assistance to the Government of Mozambique to address some of the weaknesses identified and discussed in World Bank, 2012.

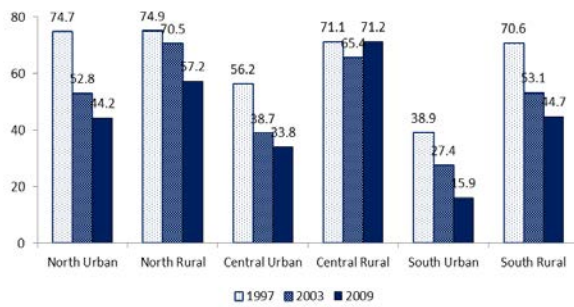
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<sup>2</sup> Income per capita is measured as Gross National Income (GNI) per capita at constant domestic prices. GEPR estimates remain the same with alternative measure of income per capita such as GDP or GNI (PPP) per capita at constant prices

<sup>3</sup> See "Poverty in Mozambique: New Evidence from Recent Household Surveys" (World Bank 2012) for a discussion on those methodological differences.

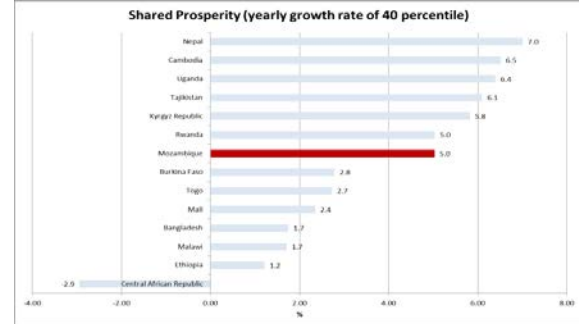


Figure 1: Poverty Headcount Rates by Region and Location



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

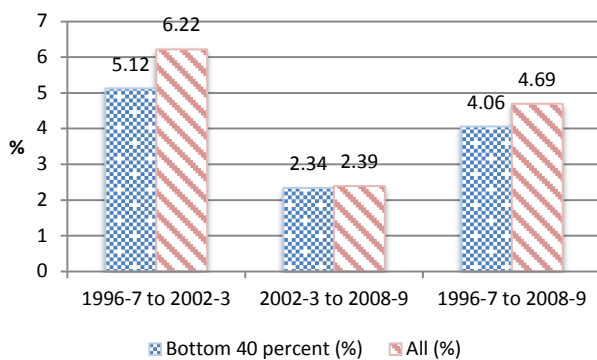
Figure 2: Yearly growth rate of consumption of the bottom 40 percent



Source: World Bank Staff Estimates.

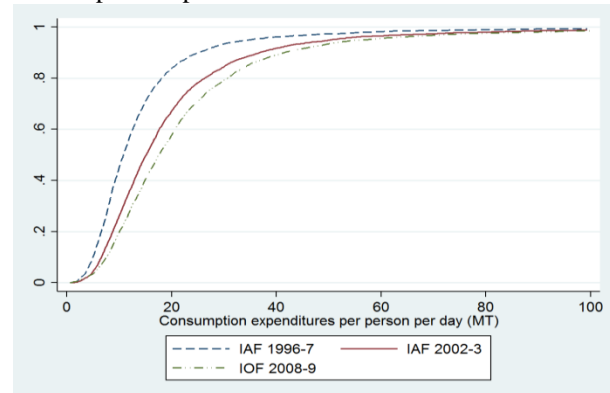
**6. The bottom 40 percent of the population have so far benefited less from growth than the overall population.** Between 1996-97 and 2008-09 average consumption of the bottom 40 percent of the population grew by 4.0 percent per year, while that of the total population grew by 4.7 per year. The gap in consumption growth between the bottom 40 percent and the total population was significantly larger between 1996-97 and 2002-03, but in the latter period consumption growth more than halved for all. A comparison of consumption patterns of the bottom 40 percent with other low income countries shows that Mozambique is on par with many peers (Figure 2), 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.

Figure 3: Annual average growth rate of per capita consumption



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

Figure 4: Cumulative distribution function of consumption expenditures



Source: IOF and World Bank Staff Estimates.

**7. In addition to pervasive monetary poverty Mozambique faces enormous challenges in improving social indicators.** In 2013 Mozambique's per capita income was US\$593, less than one-third of the Sub-Saharan Africa (SSA) average. Mozambique ranked 178<sup>th</sup> out of 187

countries in the United Nations (UN) Human Development Index (HDI) 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 and alleviating hunger and malnutrition. 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. This PRSC series is an important component of the Country Partnership Strategy (CPS) approved 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 the most appropriate instrument to support the Government’s poverty reduction agenda. The reforms supported by the PRSC series will contribute to a more inclusive growth pattern which will be crucial for reestablishing a strong relationship between growth and poverty reduction. Reforms to simplify business licensing and registration will improve the business environment, supporting private sector growth and employment creation. Efforts to improve public investment management systems will result in investments with higher returns and a bigger impact on the wellbeing of the population. And a scaling up and improvement of social protection programs will enhance the Government’s ability to support the poorest and most vulnerable in the population.

## **2. MACROECONOMIC POLICY FRAMEWORK**

### **2.1 RECENT ECONOMIC DEVELOPMENTS**

**9. Mozambique’s GDP growth rate exceeded 7 percent in the past three years.** Growth in 2013, at 7.4 percent, was slower than initially projected as floods in much of the country diminished agricultural production and damaged infrastructure. Agriculture employs 78 percent of the labor force and accounts for about 28 percent of GDP. Trade and retail services make up 12 percent of GDP, while the weight of the industrial sector continues to decline from 17 percent of GDP a decade ago to 12 percent in 2013, despite large projects such as Mozal that provided a boost to the industrial sector in the past decade. Growth has been broad-based across economic sectors over the past few years. The main contributors to GDP growth in 2013 were financial services, agriculture and trade. Extractive industries is the most dynamic sector in the economy but its contribution to growth remains limited given its relatively small share in the economy.

Figure 5: Sectoral contribution to GDP growth

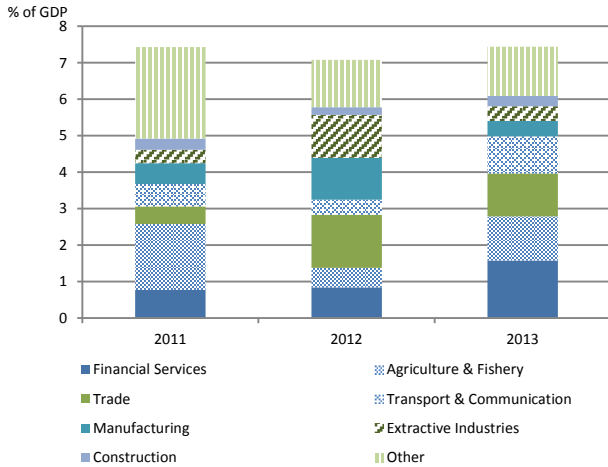
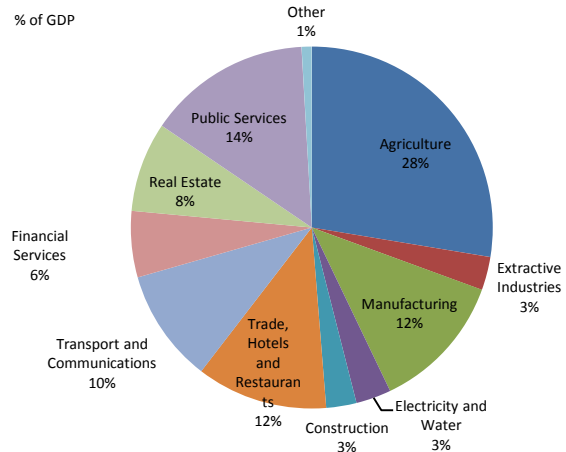


Figure 6: Sectoral breakdown of GDP in 2013



Source: Instituto Nacional de Estatística (INE) and World Bank Staff Calculations.

**10. The economy grew at 6.9 percent in the second quarter of 2014, 3 percentage points lower than in the second quarter of 2013.** While growth in agriculture and manufacturing accelerated, it moderated in the extractives sector to 12.6 percent, the result of low commodity prices and infrastructure constraints that continue to affect the coal sector. Domestic savings continue relatively low and unable to finance the large public and private investments being implemented, resulting in large current account deficits. Mozambique adopted in 2014 a new base year (2009) for the compilation of national accounts, taking into account new available data sources as well as new sectors of economic activity. The revised GDP figures are slightly higher than previous GDP figures (4 percent higher in 2012).

**11. The extractive industries are Mozambique’s most dynamic sector, growing by 90 percent over the past few years.** Over the next decade, resource extraction will alter the structure of the economy through large-scale investment in the infrastructure and facilities necessary to extract, process and transport minerals and natural gas. Strong growth in the extractive industries could negatively affect economy-wide competitiveness by exerting upward pressure on the exchange rate and diverting scarce capital away from the non-resource sectors (a phenomenon known as Dutch Disease). There is no sign of this in the economy yet. Upward pressure on the exchange rate has been partially contained by the foreign-financed and import-intensive nature of the sector. Over the long term though, as the sector goes into the operational phase and exports grow, the exchange rate may appreciate and affect competitiveness.

Table 1: Key Macroeconomic Indicators, 2011-2017

	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.
GDP (nominal – billion meticaís)	385	424	470	526	595	680	774
Consumption (% of GDP)	96.1	93.7	92.6	--	--	--	--
Investment (% of GDP)	18.4	15.6	17.9	--	--	--	--
Net exports (% of GDP)	-14.5	-9.3	-10.4				
Real GDP growth rate (%)	7.4	7.1	7.4	7.5	7.5	8.1	7.8
CPI inflation (% , annual average)	10.4	2.1	4.2	2.6	4.4	5.2	5.6
CPI inflation (end of period)	5.5	2.2	3.0	3.0	5.5	5.6	5.6
Base Money (% change)	8.5	19.7	15.7	19.0	18.5	15.6	15.6
Credit to the economy (% change)	6.4	19.9	28.7	21.2	18.0	15.0	15.0
Policy lending rate (end of period)	15.00	9.50	8.25	8.25*	--	--	--
Gross domestic savings, exc. grants (% of GDP)	2.1	4.1	8.8	6.8	6.0	7.6	10.0
Gross domestic investment (% of GDP)	31.7	51.4	49.5	49.0	54.1	57.4	55.3
Government	14.1	12.9	15.2	17.8	16.0	16.0	15.7
Other sectors	17.6	38.5	34.3	31.2	38.1	41.4	39.6
Total government Revenues (% of GDP)	19.7	22.4	26.9	27.3	25.4	25.5	25.6
Total government Expenditure (% of GDP)	31.9	31.4	34.9	41.9	36.4	36.0	35.2
Overall balance (after grants) (% of GDP)	-5.0	-4.0	-2.8	-10.1	-7.5	-7.3	-6.5
Terms of trade (% change)	2.8	-5.7	-9.0	-3.3	1.5	-0.7	-1.2
Current account balance, incl. grants (% of GDP)	-23.1	-43.6	-37.7	-39.4	-45.7	-47.6	-43.3
Real exchange-rate change (% change)	18.7	10.6	6.3	--	--	--	--

Sources: Banco de Moçambique (BdM), International Monetary Fund (IMF) and Bank estimates and projections.

\*Note: 8.25 percent until October 2014.

**12. Fiscal policy has become expansionary.** Tax revenues have grown at a rapid pace, from 17.2 percent of GDP in 2011 to 23.4 percent in 2014, reflecting efforts to improve tax administration and capital gains taxes from the extractives industries. Without capital gains taxes, tax revenues have increased by 1 percentage point per year over the past few years. This increase in revenue has compensated for a decline in aid flows, which in 2013 financed less than 30 percent of expenditures. Spending has been growing at a rapid rate, reaching 35 percent of GDP in 2013 and projected at 42 percent in 2014. The wage bill has increased by 1.8 percentage points of GDP and goods and services increased by 4.8 percentage points over the past few years, although much of this increase is related to the inclusion of a share of the *Empresa Moçambicana de Atum* (EMATUM) operation in the budget. Most of the wage bill increase was the result of additional hiring in priority sectors, especially education and health, as well as the temporary hiring of election staff for the 2014 elections. Personnel costs are expected to slowly decline below 10 percent of GDP by 2017. Capital spending (including on-lending) has increased by almost 5 percentage points over the past two years as infrastructure investment increased.

**13. In August 2014 the national assembly passed a revised 2014 budget that increased public spending to 42 percent of GDP.** The revised budget increased spending by an additional 1.5 percentage points of GDP compared to the original budget. On the revenue side, the revised budget includes capital gains taxes collected in early 2014. On the expenditure side, additional spending was allocated to personnel costs related to the elections and infrastructure projects<sup>4</sup>. The budget deficit (after grants) will increase to over 10 percent of GDP, highlighting the need to tighten fiscal policy. The large balance in 2014 also results from different accounting methods. The Government collected US\$400 million (2.2 percent of GDP) in capital gains taxes in August

<sup>4</sup> The Government proposed to include US\$100 million to refund VAT and address a key concern of the private sector with VAT refund delays. This was not approved by parliament which reallocated it to investment projects.

2013. These were incorporated by the Government in the 2014 budget (financing 2014 spending) while the fiscal framework presented below incorporates this revenue in the 2013 budget.

Table 2: Fiscal Framework, 2011-2017

	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.
	(% of GDP)						
Total revenues	19.7	22.4	26.9	27.3	25.4	25.5	25.6
Tax revenue	17.2	19.1	22.9	23.4	21.6	21.7	21.8
Income and profits	6.5	8.7	11.9	10.9	9.0	9.2	9.3
Taxes on goods and services	8.6	7.9	8.1	9.4	9.4	9.4	9.4
International Trade	1.7	1.8	2.1	2.1	2.2	2.2	2.2
Other	0.4	0.8	0.7	1.1	1.0	0.9	0.9
Nontax revenue	2.5	3.3	4.0	4.0	3.8	3.8	3.8
Grants received	7.4	5.2	5.3	4.0	3.6	3.3	3.1
Total expenditures and net lending	31.9	31.4	34.9	41.9	36.4	36.0	35.2
Current expenditures	17.8	18.5	19.7	24.1	20.4	20.0	19.5
Compensation to employees	9.3	9.8	10.5	11.1	10.7	10.2	9.8
Goods and Services	3.1	3.6	4.3	7.9	4.6	4.4	4.1
Interest payments	0.9	1.0	0.8	1.2	1.2	1.5	1.6
Transfers	4.5	4.1	4.0	4.0	4.0	4.0	4.0
Capital expenditures	13.1	11.9	13.1	14.5	13.9	13.4	12.2
Externally financed	7.9	6.0	6.0	6.9	7.0	6.7	5.3
Domestically financed	5.3	5.8	7.1	7.6	6.9	6.7	6.9
Net Lending	1.0	1.1	2.1	3.3	2.1	2.6	3.5
Externally financed	0.8	1.1	2.2	3.2	2.0	2.5	3.3
Domestically financed	0.1	-0.1	-0.1	0.2	0.2	0.2	0.1
Domestic primary balance (before grants)	-2.8	-1.0	0.9	-2.9	-0.9	0.1	0.7
Overall balance (before grants)	-12.4	-9.1	-8.1	-14.5	-11.1	-10.6	-9.6
Overall balance (after grants)	-5.0	-4.0	-2.8	-10.6	-7.4	-7.3	-6.5
Total financing	5.0	3.9	2.8	10.6	7.5	7.3	6.4
External (net)	3.5	3.3	5.8	9.4	6.4	6.1	5.6
Domestic (net)	1.5	0.7	-3.0	1.2	1.1	1.2	0.8
<i>Memorandum items:</i>							
Total public debt*	37.5	41.1	52.3	56.8	59.5	60.6	60.5
External	31.2	35.5	43.5	48.4	51.1	52.0	52.1
Domestic	6.3	5.6	8.8	8.4	8.5	8.6	8.4

Sources: Government of Mozambique (GoM), IMF and World Bank estimates and projections.

Note: \* Consistent with DSA definition, includes non-concessional Portuguese credit line, may differ from GoM definition.

**14. Inflation rates have been relatively low and stable during the past two years.** An inflationary spike in 2010 led to the adoption of tighter monetary policies by the Mozambican Central Bank (*Banco de Moçambique – BdM*), and inflation has since been contained below the BdM target of 5-6 percent. Inflation, estimated at 1.4 percent (year-on-year) in September 2014, remains low. Low inflation and a weaker external environment enabled BdM to ease its monetary policy rates are at a record low of 8.25 percent. These efforts had limited impact on market rates and credit growth has accelerated slowly, given a weak monetary transmission mechanism. Given the more expansionary fiscal policy in 2014 it will be necessary to monitor inflation and proactively coordinate fiscal and monetary policies.

**15. Despite the impact of successive external shocks the Government has succeeded in managing exchange rate volatility without compromising the integrity of the flexible exchange rate regime.** Exchange rate stability has been supported by the progressive de-dollarization of the economy, with the share of foreign currency in broad money falling from 50 percent to 35 percent over the past decade. The authorities remain committed to bolstering

macroeconomic stability in the context of a flexible exchange rate by encouraging the use of domestic currency in financial transactions and by deepening the financial sector.

**16. Financial sector indicators are broadly positive.** The banking industry is highly concentrated and profitable. The three largest banks own 85 percent of total assets, down from 100 percent in 2004. Credit to the economy reached 33 percent of GDP in 2013, led by rising credit to households. The average profitability of the banking sector as measured by return on equity declined from 61 percent in 2006 to 20 percent in 2012, but remains somewhat higher than the SSA average. The banking system is well-capitalized, with a capital adequacy ratio of 18 percent in 2012 and a Tier 1 capital ratio of 17 percent—well above the regulatory minimum of 8 percent. It is also highly liquid; in 2012 the ratio of liquid assets to total liabilities was 33 percent in a banking system largely funded by deposits. Non-performing loans have been rising steadily, though slowly, since 2009 and remain relatively low at 3.2 percent.

**17. Mozambique’s export basket remains very limited, reflecting the narrow scope of the economy: in 2013, three items (aluminum, coal and electricity) accounted for 45 percent of exports.** Total exports grew at an average annual rate of 13 percent from 2004 to 2013, driven by foreign-financed megaprojects in the 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, with gas exports anticipated to eventually exceed the total value of current exports. In the first quarter of 2014 exports fell by around US\$100 million, the result of relatively low commodity prices.

**18. Imports are rising rapidly, resulting in persistent current account and trade deficits.** 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 been increasing rapidly. The 2013 current account deficit reached US\$5.9 billion or 38 percent of GDP. The current account deficit narrowed to US\$1 billion in the first quarter of 2014, supported by record high capital gains taxes paid by foreign firms engaged in the development of the gas sector. Capital gains taxes had also narrowed the deficit in 2013. The current account deficit does not indicate a fundamental imbalance in the economy, as it reflects the impact of rapid import growth associated to large FDI inflows. 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 US\$5 billion in both 2012 and 2013, or around 1/3 of GDP, and financed over 80 percent of the current account deficit. This trend compares favorably to most of the last decade, when FDI financed 35 percent of the deficit. Reserves continue to increase and reached US\$3.2 billion or 3.9 months of imports excluding mega projects by end 2013.

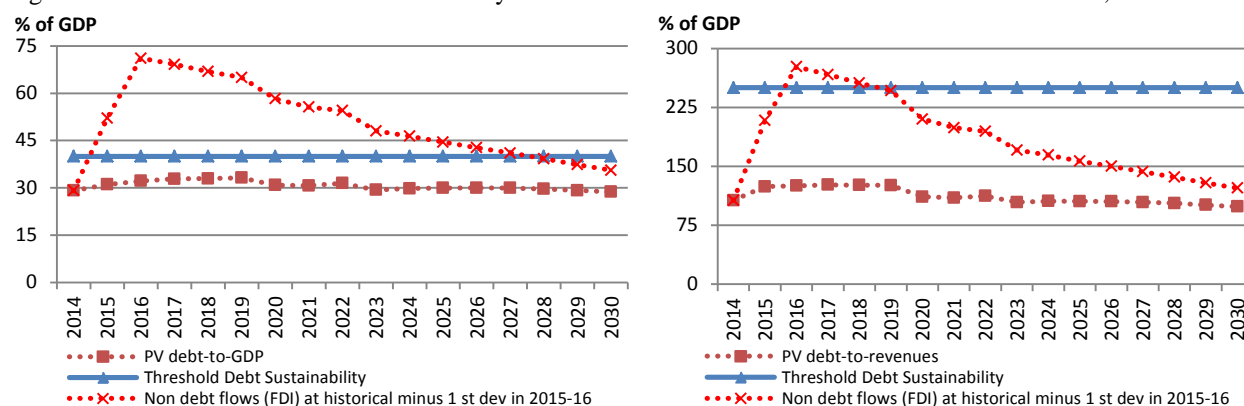
Table 3: The Balance of Payments, 2011-2017

	2011	2012	2013	2014	2015	2016	2017
	Act.	Act.	Est.	Proj	Proj.	Proj.	Proj.
	(US\$ millions)						
Trade balance (goods)	-2,249	-4,048	-4,357	-4,594	-6,012	-6,971	-6,155
Exports, f.o.b.	3,118	3,856	4,123	4,610	4,958	5,367	6,780
<i>Of which:</i> megaproject exports	2,015	2,219	2,201	2,604	2,675	2,908	4,061
Imports, f.o.b.	-5,368	-7,903	-8,480	-9,204	-10,971	-12,338	-12,934
<i>Of which:</i> megaproject imports	-1,547	-2,143	-1,934	-2,037	-3,407	-4,109	-3,982
Trade balance (services)	-1,482	-3,273	-2,802	-3,230	-3,196	-3,390	-3,831
Income balance	-190	7	-52	-162	-247	-475	-1,023
<i>Of which:</i> dividend by megaprojects	-157	0	-1	-127	-135	-293	-718
Current account balance (before grants)	-3,844	-7,022	-6,352	-7,119	-9,043	-10,409	-10,562
Current transfers	863	829	1,319	1,331	857	888	926
<i>Of which:</i> External grants	785	538	460	464	444	462	480
Current account balance (after grants)	-3,059	-6,484	-5,892	-6,655	-8,599	-9,947	-10,082
Financial account balance	3,041	6,748	6,240	6,775	8,848	10,323	10,753
Net foreign borrowing (general government)	531	546	1,055	1,673	1,162	1,150	1,184
Net foreign borrowing (nonfan. private sector)	-39	516	148	411	1,692	2,902	3,396
Net Foreign Direct Investment	2,599	5,215	5,055	4,230	4,833	4,952	5,015
Other investments	-482	14	-1,385	-99	550	658	442
Overall Balance	323	177	396	120	249	375	671
<i>Memorandum items:</i>							
Current account balance (in % of GDP)	-23.1	-43.6	-37.7	-39.4	-45.7	-47.6	-43.3
Gross international reserves ( in US\$ million)	2,428	2,799	3,192	3,310	3,524	3,863	4,497
In months of projected imports	2.5	2.7	2.8	2.6	2.5	2.5	2.3
In months of projected imports (exc. mega projects)	3.0	4.0	3.9	3.8	3.9	3.9	4.2

Sources: BdM, IMF and World Bank estimates and projections.

19. **Public debt (in nominal terms) has grown rapidly, from 37 percent of GDP in 2011 to 52 percent in 2013.** This increase reflects the growth of both domestic and external debt. A large share of this debt was contracted on non-concessional terms. The share of non-concessional loans in new external debt increased from 9 percent in 2010 to over 70 percent in 2012. As a result, the joint WB-IMF debt sustainability analysis (DSA) for Mozambique has increased the country's risk rating from low to moderate. All public and external debt indicators remain below their threshold levels, but under a number of stress scenarios they breach their thresholds. New debt is being used to finance a large increase in infrastructure investment to close the country's infrastructure deficit. Infrastructure investments, if they generate high returns, could result in higher growth in the medium term, an aspect not considered in the DSA. 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 the management of these. Reforms supported by this operation will result in both improved public investment and fiscal risks management.

Figure 7: The Evolution of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2014-30



Source: International Monetary Fund and International Development Association, (2014), "Mozambique Debt Sustainability Analysis," Washington DC.

20. **The EMATUM operation 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 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). Following discussions with development partners, the Government committed to subject EMATUM to strict financial controls and audits and to revise the Organic Budget Law to require an annex on fiscal risks. The Government and development partners agreed on an action plan focused on improving public investment and fiscal risks management. Some of these reforms are supported by this operation.

## 2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

21. **Mozambique's medium-term macroeconomic outlook is positive.** Annual growth is projected between 7.5-8 percent during 2014-17 driven by the resource sector, agriculture, construction, transportation and communications. In the short run coal exports, resource-related FDI and infrastructure investments, both public and private, are expected to be major contributors to growth. Inflation is projected to stay between 5 and 6 percent through 2017.

22. **The authorities have committed to tighten fiscal policy and this commitment is reflected in the 2015 budget being prepared.** The authorities plan to reduce public spending from 42 percent in 2014 to 34 percent in 2019 and the overall deficit (after grants) from over 10 percent in 2014 to around 5 percent in 2019. The authorities expect that such a reduction in spending would be achieved as expenditure returns to a normal path after the implementation of one-off outlays on elections and maritime security in 2014. They also have a plan to reduce the wage bill gradually from its elevated level of 11 percent of GDP in 2014, and expect slower growth in expenditure on goods and services and investments. The authorities expect the domestic primary balance (before grants) to decline from a deficit of about 3 percent of GDP in 2014 to a 1 percent of GDP surplus by 2019. The new Government and national assembly will be



inaugurated in early 2015 and the state budget for 2015 will only be approved in March 2015. The 2015 budget prepared by the outgoing Government reflects the commitment to tighten fiscal policy by reducing spending by 5.5 percentage points of GDP and the after grants deficit by 2.6 percentage points of GDP, as reflected in the fiscal framework in this document.

**23. BdM will continue to maintain a policy stance consistent with single-digit inflation.** After significantly easing monetary policies in 2013 BdM will focus on keeping inflation low through 2014, and favorable import prices are expected to support these efforts. In the context of a relatively expansionary fiscal policy it will be important to closely monitor price developments and coordinate fiscal and monetary policies. 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, although increasing, remains sustainable given its financing by FDI into tradables.** The current account deficit is projected to increase to around 45 percent of GDP in 2014-15. While both new and traditional exports are projected to grow rapidly, so are imports required by large-scale investments in the minerals and gas sectors, generating large current account deficits through the end of the decade. 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 are to be expected. These deficits will be financed by FDI inflows, projected at between US\$4-5 billion per year during 2014-17, as well as foreign borrowing by investors in the mining and natural gas sectors. The anticipated rise in resource exports should improve the current account balance toward the end of the decade. Reserves are projected to increase, from US\$3.2 billion in 2013 to a projected US\$4.5 billion by 2017, worth around 4 months of projected imports (excluding megaproject imports) during the same period.

**25. The total public debt stock will reach 57 percent of GDP by 2014 and will continue to rise in the near term.** Limited domestic savings and a significant increase in both public and private investment have resulted in widening current account and fiscal deficits. As discussed above, the large current account deficit does not represent a fundamental imbalance in the economy, but is primarily the result of massive FDI inflows into the extractive industries that are both capital and import intensive. The fiscal tightening discussed above as well as slower growth in public investments will reduce the fiscal deficit. The Government is aware of the risks posed by inadequate controls on borrowing, and it has expressed its intention to both slow the growth of new public external debt and reduce the share of non-concessional loans. 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. These efforts will be complemented by reforms to improve fiscal transparency and enhance public investment efficiency.

**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 leave Mozambique's economy vulnerable to declining export demand, volatile commodity prices and tighter global financial conditions.

Weaker international commodity markets could affect large-scale investments planned for the coal and gas sectors, such as the currently low coal prices which seem to have affected investment plans by coal producers. 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 year the Government security forces and the armed wing of the opposition party, *Resistencia Nacional Moçambicana*-RENAMO, have repeatedly clashed. Although tensions now appear to have subsided, events in the last year 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 the proposed 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 Government remains committed to prudent monetary and fiscal policies as reflected in the Memorandum of Economic and Financial Policies prepared by the Government as part of the PSI review and evidenced by the fiscal consolidation effort reflected in the proposed 2015 budget which will narrow the deficit by over 2.6 percentage points in one year. This fiscal consolidation will need to continue in the near term. Further macroeconomic management reforms are currently being supported through technical assistance and by the current PRSC series. These reforms, described in detail below, will support the continued implementation of prudent monetary and fiscal policies.

### 2.3 IMF RELATIONS

**28. The IMF concluded its mission to hold discussions towards completing the 3<sup>rd</sup> PSI review.** The 2<sup>nd</sup> review, presented to the Board in May 2014, acknowledged Mozambique’s strong growth record and reform agenda, but also highlighted a number of areas where additional efforts would be needed. In addition to stressing the need to tighten fiscal policy, the review recommended renewed efforts to reform Public Financial Management (PFM) systems, in particular the management of fiscal risks and public investments. The 2<sup>nd</sup> PSI review increased the limit on public commercial borrowing to US\$1.5 billion for the duration of the program (2013-16), based on discussions on potential projects as well as taking into account the DSA. The current mission concluded that Mozambique’s economic performance remains robust and reached agreement with the Government on slowing expenditure growth in 2015. Program performance is mixed, and authorities committed to reforms to (i) further strengthen public resources management, (ii) enhanced transparency and efficiency of public investment, and (iii) strengthened the management of public enterprises. This PRSC series is largely aligned with the reform priorities identified in the PSI program. The 3<sup>rd</sup> PSI review will be presented to the board in early January 2015 (see press release in annex 3 on this IMF mission).

### 3. THE GOVERNMENT’S PROGRAM

**29. The PARP is based on three strategic pillars supported by two cross-cutting pillars.** Its 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, by expanding access to inputs and better integrating domestic producers into national and international markets; (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 by extending access to public services and basic infrastructure. The two cross-cutting support pillars are good governance and macroeconomic stability, which are regarded as necessary conditions for the realization of the PARP's strategic goals.

30. **The PARP is aligned with the Government's planning and budgeting systems.** The PARP, Mozambique's third poverty reduction strategy paper, was approved by the council of ministers in mid-2011 and was developed through a broadly consultative process involving representatives from a range of Government agencies as well as stakeholders from the private sector and civil society. Its implementation period was originally intended through the end of 2014, but it has recently been extended until 2015 to allow the next Government to design its own poverty reduction strategy. The PARP is aligned with the Government's 5-year development plan (*Plano Quinquenal do Governo-PQG*). The PQG and the PARP are operationalized through annual implementation plans (*Plano Económico e Social – PES*) and budgets (*Orçamento do Estado – OE*), both approved by the national assembly. PARP is also broadly aligned with sector-specific strategies, such as in agriculture, financial sector development or improvement of the business environment. Progress in PARP implementation is assessed through yearly reviews conducted jointly by the Government and G19<sup>5</sup> on the basis of the PARP performance assessment framework (PAF).

## 4. THE PROPOSED OPERATION

### 4.1 LINKS TO GOVERNMENT'S PROGRAM AND OPERATIONAL DESCRIPTION

31. **The proposed PRSC-10 would be the second in a series of three annual operations.** The PRSC series is harmonized with the G19 joint-donor mechanism for the provision of general budget support. Reforms supported by the PRSC series are in line with the PARP's strategic pillars and the objectives defined in the PARP results matrix.

32. **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 V of this document.

#### Previous PRSC Series and Lessons Learned

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<sup>5</sup> The G19 is the group of budget support donors. Although still known as the G19 this group currently comprises 16 active partners. These are: the African Development Bank, Austria, Canada, Denmark, the EU, Finland, France, Germany, Ireland, Italy, Norway, Portugal, Sweden, Switzerland, the UK, and the World Bank. Two associate members, the United States and the United Nations, participate in group's policy dialogue, but do not provide budget support. The IMF is an ex-officio member of the budget support group.

33. **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 G19-GoM performance framework and was consistent with the contemporaneous CPS for FY2008-2011. A recent evaluation of budget support in Mozambique<sup>6</sup>, analyzing the impact of budget support from 2005 to 2012 on development outcomes, suggests that budget support has been successful in achieving its objectives, although it recognized weaknesses in the use of the instrument, in particular in the quality of the policy dialogue.

34. **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.

35. **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 G19-GoM PAF. This PAF is focused on monitoring the achievement of desirable results, but which are not necessarily guided by a prioritized agenda of well-defined policy measures. A major area of discussion between the G19 and the Government is how to revise the PAF to design a policy-focused results framework which better links policy actions with results sought. The results framework used for this third series, although still largely aligned with the Government’s PARP and the PAF used by the G19, includes clearly specified policy and institutional reforms as well as clearly linked outcome indicators. This is a departure from the PAF used by the G19 that focuses primarily on the monitoring of outputs and results.

36. **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 MPD 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 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 newly created M&E directorate in MPD and is an active member of the joint GoM-donors working group on monitoring and evaluation. The Bank is also providing 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.

37. **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

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<sup>6</sup> 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

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 has renewed efforts to support 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.

**38. Implementation of reforms in PRSC-9 has informed the preparation of this second operation in the series.** There is significant continuity in the reforms being supported and few changes between the triggers for PRSC-10 identified at the time of PRSC-9 board presentation and the proposed prior actions, illustrating the Government commitment to the reforms. The Implementation Status and Results prepared for PRSC-9 has informed the preparation of this operation, including the need to deepen reforms in the public investment and fiscal risks management areas. As a result, new prior actions have been added in both reform areas. The current operation does not include the draft Fiscal Regime for Mining as a prior action as more time will be needed to evaluate market reactions to this revised fiscal regime. The Bank's assessment is that the approved fiscal regime may be putting excessive fiscal pressure on potential investors and as a result it may hinder investment. A reform that is progressing well and does not need the higher level attention provided through this operation is the scaling up of resources to the General Inspectorate of Finance (IGF) and the Internal Control Units (OCI) for improving follow-up to audits. This reform continues to be important but is being supported and monitored closely by the G19 and is therefore not included as a prior action in this operation. Table 4 summarizes the changes between the triggers identified for PRSC-10 in PRSC-9 and the prior actions proposed for this operation.

**Table 4: Comparison of triggers and prior actions for PRSC-10**

<b>PRSC-10 trigger identified in PRSC-9</b>	<b>PRSC-10 proposed prior action</b>	<b>Comments/ Status</b>
The Council of Ministers approves the revised Industrial Licensing Decree	The Council of Ministers has approved the Industrial Licensing Decree	No change
The Government simplifies business registration by reducing the number of procedures and/or allowing them to proceed in parallel	The Council of Ministers has adopted a single form for opening a new business and start activities	No change
The Council of Ministers approves the draft Fiscal Regime in Mining and sends it to the National Assembly for discussion and approval.		Prior action not included due to reservations about potential fiscal pressures on investors (see explanation in paras 46-47).
The Council of Ministers approves the draft legislation for the new Fiscal Regime in Petroleum and sends it to the National Assembly for discussion and 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	No change
Preliminary assessment of the transfer program for 2013 and continuation of the program for in the State Budget for 2014.		The program has continued and an assessment has been prepared by the Bank together with MoF. The assessment is the basis for discussions between donors and Government to

PRSC-10 trigger identified in PRSC-9	PRSC-10 proposed prior action	Comments/ Status
		discuss revisions to the transfer program to be implemented in 2015.
A single registry of beneficiaries for all INAS programs providing cash as benefits has been developed and adopted	The National Institute of Social Action (INAS) has developed and adopted a single registry of beneficiaries for all INAS programs providing cash to beneficiaries	No change
The formal payment system is defined, piloted and adopted	INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the payment distribution system	Revised slightly to reflect the progress in establishing the payment distribution system
The Ministry of Finance scales-up resources to increase capacity of IGF and OCI for improving following up of audit recommendations		Prior action not included. This reform is progressing well but it has not been included to incorporate other relevant reforms that may benefit more from inclusion in the operation
	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	New prior action to promote the appraisal and evaluation of public investment projects following up on the development of the manual for project appraisal in PRSC-9
The Social and Economic Council of Ministers has adopted the Integrated Investment Program	The Council of Ministers has adopted the <i>Programa Integrado de Investimentos 2014-2017</i>	No change
The Ministry of Finance completes, publishes and implements the first annual domestic borrowing plan, prepared based on the Medium Term Debt Management Strategy	The Ministry of Finance has implemented the first annual domestic borrowing plan, prepared based on the medium term debt management strategy	No change
	The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012)	New prior action to support reforms in fiscal risks management, an emerging concern in Mozambique

## 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*

39. **Mozambican firms are significantly constrained by the high administrative cost of doing business.** Firms face a complex web of rules and regulations that hinder growth in Mozambique. A survey of manufacturing firms conducted in 2012<sup>7</sup> revealed that over 30 percent of all firms identified business licensing and registration as a major constraint to growth, a significant increase from those that identified it as a constraint in 2006. The latest *Doing Business* report shows a significant improvement in Mozambique's ranking, from 139<sup>th</sup> in 2014 to 127<sup>th</sup> in 2015 (out of 189 economies). Reforms to property registration and resolving insolvency, in addition to recent efforts to improve cross-border trade and expedite the approval of construction permits, have resulted in an improvement in the ranking of Mozambique over the past few years. Business climate reforms are a top priority of the PARP. This reform agenda is also supported by the Bank's Private Sector Development and Competitiveness Program and the IFC's Mozambique Investment Climate Program. The series will complement these efforts by supporting the achievement of the Government's objectives under the second pillar of the PARP, fostering increased private investment. Reforms in this area include simplifying business-licensing procedures and developing a more efficient and less burdensome business registration process.

<b>PRSC-10 Prior action 1: The Council of Ministers has approved the Industrial Licensing Decree</b>
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40. **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 of 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. Together, these efforts have resulted in a reduction in the number of days required to obtain a business license, from 15 days to 8 days for activities that require pre-inspection and to 10 days for activities that do not; a reduction in the total number of procedures required for regulatory compliance; and a 38 percent reduction in the cost of regulatory compliance.

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<sup>7</sup> MPD, 2013, "2012 Survey of Mozambican Manufacturing Firms"

41. **In March of 2014 the Government approved the industrial licensing decree** (prior action for PRSC-10). The new regulations dramatically reduced the time required to issue industrial licenses. The number of days for processing industrial licenses for MSMEs was cut by 89 percent, from 62 days to 7, for economic activities that pose no risk to human health, safety or the environment. Licensing times for large industries were reduced by 50 percent, from 62 days to 31 days. The revisions of the commercial and industrial licensing regulations will result in a reduction of the time to obtain a commercial license from 15 to 7 days and of the time to obtain an industrial license from 40 to 20 days by the end of the program.

**PRSC-10 Prior action 2: The Council of Ministers has adopted a single form for opening a new business and start activities**

42. **The Government has streamlined the number of procedures required to establish a new business.** The IFC is providing technical assistance to Government reforms to expedite the business startup process by making sequential procedures concurrent. As a result, the Government established new Simplified Business Startup Procedures (Decree 80/2013) that included the adoption of a “single-form” system for registering new businesses (prior action for PRSC-10). The single form consolidates a number of processes that were formerly separate, and private firms may now submit all required information at the Government’s “one-stop shop” for business registration (BAU). This is expected to cut the number of steps required for regulatory compliance from 9 to 5, a 44 percent reduction. The Government will shortly introduce the e-BAU, an integrated IT platform - allowing further streamlining through automation of business start-up procedures (registration, NUIT processing, licensing of economic activities). Furthermore, the related ‘Citizen Portal’ will increase access to information for business regulations by hosting information on valid business licenses, including needed procedures, requirements, downloadable forms, etc. (trigger for PRSC-11). The e-BAU is currently being piloted in 6 cities (Maputo, Xai-Xai, Inhambane, Beira, Nampula and Pemba). 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. **Mozambique achieved compliance status with the EITI standard in 2012 and disclosure of contracts in the EI sector has progressed in the past year.** EITI compliance 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 4<sup>th</sup> EITI report published in March 2014 reaffirmed Mozambique’s compliant status. The 5<sup>th</sup> report, due December 31, 2014, will determine Mozambique’s compliance with the revised EITI standard (trigger for PRSC-11), adopted in May of 2013. The revised 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. By the end of the program Mozambique 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.



44. **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. During the approval process, national assembly introduced significant changes to the proposed legislation, in particular the possibility of increased state participation in new investments. The submission of these sectoral laws to the national assembly were prior actions for PRSC-9 and implementing regulations, to be approved by the council of ministers, are triggers for PRSC-11. By the end of the series it is expected that at least 2 new mining and 2 new gas-related contracts will be negotiated under the revised legislative framework.

45. **The national assembly approved in August 2014 revised Fiscal Regimes for the Mining and Hydrocarbon Sectors** (in Portuguese the *‘Regime Específico de Tributação da Actividade Mineira’* and the *‘Regime Específico de Tributação das Operações Petrolíferas’*). The approved fiscal regimes revise legislation that had been adopted in 2007. The new laws seek to adjust Mozambican legislation to international practice, collect all relevant fiscal aspects in one law for each sector, and improve the business environment while increasing Government revenues, ultimately having a fiscal regime that is both fair and stable. The Government held wide public consultations on these reforms. During the revision the Bank, the IMF and other development partners provided advice to the Government, which incorporated several of the recommendations provided. The revised fiscal regimes will govern taxes on production, accelerated depreciation, stabilization clauses and other elements of resource management. These reforms are expected to address some of the concerns voiced by civil society regarding the relatively small share of resource rents currently captured by the Government.

46. **Passage of the revised Fiscal Regime for Mining is an important milestone in Mozambique’s efforts to leverage its natural resources in support of its development objectives.** The revision of the fiscal regime for mining includes some positive elements, including the fact that all provisions regarding taxation of the mining sector is now included in the same legislation. Some of the key elements in this reform are the introduction of a new resource rent tax and clarification on many aspects related to corporate income taxes (e.g. transfer pricing, depreciation rates, capital gains taxes). Royalty rates foreseen in the legislation are in line with those levied by other mining producers.

47. **There are concerns that the approved Fiscal Regime for Mining may impose an excessively high burden on potential investors and discourage investment.** The revised fiscal regime specifies that royalties are to be paid on resources extracted rather than resources sold. The regime does not allow royalties to be deducted from corporate income tax liability. Both of these elements could result in excessive fiscal pressure in the mining sector and as a result lower investment. These provisions are not in line with those in the fiscal regimes of many other mining countries, including Brazil, Ghana, Indonesia, Peru and South Africa. Other expenditures such as Corporate Social Responsibility and resource rent taxes cannot be deducted either from corporate income tax liability, further increasing the burden on investors. The Government must continuously balance the interests of investors and the public interest, as this legislation tries to do. The Government will have a new bidding round for coal mining in the near future, to be governed by the new sector law and fiscal regime. This bidding round will be a good opportunity to test whether the new regulatory framework strikes the right balance between investors’ and the public’s interests. If the new regulatory framework deters further investment in the sector,

particularly at a time of relatively low coal prices, a further revision of the legislation may be needed and the ongoing series could support such a revision. In light of these limitations, the new fiscal regime was not included among the actions supported by this operation while the policy dialogue continues.

**PRSC-10 Prior action 3: 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**

48. **The Government has revised the Fiscal Regime for the Hydrocarbon Sector** (prior action for PRSC-10). The National Assembly approved it in August 2014. Some of the key elements in this reform include clarification on many aspects related to corporate income taxes (e.g. transfer pricing, depreciation rates, capital gains taxes), actualization of royalty rates levied on hydrocarbon products and the introduction of production sharing. The revised Fiscal Regime for Hydrocarbons represents another milestone in the country's efforts to maximize the benefits of its natural resource sector. After extensive consultations with private sector firms, civil society representatives and other stakeholders, the proposed regime appears to strike an adequate balance between investors' and the public's interests, including a production tax (royalty) of 10 percent for oil and 6 percent for gas. The Government is currently working on the implementing regulation for the sectoral legislation (trigger for PRSC 11). As a result of these reforms it is expected that at least two additional new gas contracts will be negotiated under the revised and enhanced legislative framework until the end of the series.

49. **The national assembly passed a law that authorizes the Government to prepare a decree law that will govern LNG plants development in the Rovuma Basin.** The Government is, with this law, authorized to prepare a decree that will govern investments and operations in the Rovuma Basin. Estimated investments to build the liquefied natural gas (LNG) plants and related infrastructure are in the order of US\$30 billion. This decree law had been requested by the main investors in the Rovuma Basin to be able to make final investment decisions. The decree law will establish special regimes in a number of areas, including fiscal stability, labor, foreign exchange, procurement, insurance, land and property rights and accounting. The decree law should pave the way for investors to be able to make final investment decisions in the near future.

*Extractive Industries and Subnational Transfers*

50. **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. The Government started to implement this in its 2013 budget (PRSC-9 prior action) by allocating 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. In addition to

their proximity to resource extraction sites, these localities were chosen on the basis of their poverty indicators, available infrastructure and population size.<sup>8</sup>

**51. The Government has issued specific guidelines<sup>9</sup> for the management of resource revenues by subnational governments.** These revenues are intended to finance local public investment projects. These projects should be implemented in coordination with the relevant Provincial Directorate and District Service Authority. 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. Local communities should decide the use of resource revenues under the oversight of their Local Councils. Proposed projects must be implemented within the territory of the locality; they must be socially and economically viable and sustainable; and they must emphasize the use of local human, material and resources.<sup>10</sup> In addition, local governments must utilize these funds in conformity with national regulations for public finance management.

**52. An assessment of the experience with these transfers so far suggests significant benefits but also important lessons to ensure that this initiative continues to produce benefits to affected communities.** At 2.75 percent of royalties this initiative remains small, with transfers to all districts in 2013 amounting to US\$1 million. As a share of total expenditures for affected districts the transfers were also low, accounting for between 1 and 5 percent of expenditures. The Bank, together with the Government, conducted an assessment of the experience to better understand constraints and opportunities of this initiative<sup>11</sup>. Some of the main lessons learned include the need to: (i) improve PFM and capacities at the local level, (ii) ensure meaningful participation of communities in the identification of priorities, (iii) provide additional clarification in terms of the roles of different players and explicit guidance in how funds are to be used, and (iv) the need to minimize volatility in transfers. The Government will continue with this initiative and allocated 2.75 percent of royalties to affected communities in the 2014 budget. The joint assessment is the basis for internal Government discussions and discussions with budget support donors to revise the transfer program. Revisions to the transfer program to address some of the issues identified are expected in 2015 (trigger for PRSC-11). Preliminary evidence suggests that despite constraints identified, the initiative has brought significant benefits to communities including expanded access to drinking water, more effective agricultural extension services, increased food intake, and rising local employment. After addressing identified constraints and gaining more experience, 80 percent of revenues transferred by the central government to communities will be executed by communities by the end of the program.

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<sup>8</sup> 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.

<sup>9</sup> Circular 1/MPD-MF/2013. Guidelines issued by MoF and MPD.

<sup>10</sup> National Budget Directorate (2012). 2013 Citizen Budget. MoF. Mozambique.

<sup>11</sup> World Bank, 2014, “Sharing Natural Resource Revenues with Affected Communities: Policy Options for Mozambique”

## **B. Strengthen Social Protection**

53. **A large proportion of Mozambique’s population is highly vulnerable to shocks.** These include structural food insecurity during the annual agricultural cycle, which particularly affects the rural poor; unpredictable changes in food prices, which particularly affect the urban poor; and a range of natural disasters, including droughts and floods, to which all Mozambicans are at risk. The PARP encompasses a range of measures designed to support the poorest and most vulnerable. These include actions designed to improve the quality and accessibility of social services, strengthen systems to manage and mitigate risk, expand economic and educational opportunities, and establish mechanisms to both increase and smooth consumption over time.

54. **Natural disasters such as floods, droughts, pests and cyclones can have a severe and lasting impact on household income, and they disproportionately harm the poorest.** A recent study by the Bank<sup>12</sup> estimated the relative impact of various shocks on poverty: floods and cyclones had the strongest impact, reducing 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, for example by withdrawing children from school to supplement household labor. 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.

55. **The Government still faces many challenges in supporting the poor and vulnerable.**<sup>13</sup> To support the poorest and most vulnerable, the Government is implementing a number of programs. Many social assistance programs are administratively or geographically fragmented, have low overall coverage, or are not well targeted. According to the recent Social Safety Net Assessment<sup>14</sup>, in 2011 the extent 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 assessment also revealed poor administrative coordination and duplication of programs, inconsistent benefits and institutional capacity constraints in both implementation and monitoring and evaluation. The forthcoming Mozambique Public Expenditure Review argues that some of these shortcomings have been addressed (generosity of the benefits, coverage of social protection), but also suggests that further reforms are needed. As additional resources continue to be directed to new and existing safety net programs it is imperative that public agencies establish effective mechanisms for selecting, recording and organizing beneficiaries in order to allocate funds effectively.

56. **Recognizing these challenges, the Government has launched a comprehensive initiative to strengthen the legal and institutional framework for social protection.** The Social Protection Law, passed in 2007, establishes the legal foundation and institutional structure for the social protection system. In 2009 the Government launched the National Strategy for

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<sup>12</sup> “Mozambique Poverty, Gender, and Social Assessment” World Bank, 2008.

<sup>13</sup> “Social security” refers here to all forms of social assistance, not solely transfer payments to the elderly.

<sup>14</sup> “Mozambique Social Protection Assessment” Report No. 68239-MZ. World Bank, 2012.

Basic Social Security (*Estratégia Nacional de Segurança Social Básica*—ENSSB). The ENSSB has four elements: (i) “basic social action,” which covers the operation of social-assistance programs, including progressive transfers; (ii) “educational social action,” which focuses on programs to increase school enrollment and boost attendance; (iii) “healthcare social action,” encompassing nutritional support and other basic health programs; and (iv) “productive social action,” which concentrates on employment and income-generating activities targeted to the extremely poor and vulnerable, including labor-intensive public works projects.

**57. The Government is currently working to expand the ENSSB into a comprehensive social safety net through two main programs, the PSSB and the 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 approved a strategy<sup>15</sup> designed around two major programs, which together would provide support to about 800,000 extremely poor vulnerable households in rural and urban areas once full implementation was reached.<sup>16</sup> These are the Basic Social Subsidy Program (*Programa de Subsidio Social Básico*—PSSB, formerly the *Programa de Subsidio de Alimentos*) and the Productive Social Action Program (*Programa de Acção Social Productiva*—PASP). The PSSB, a cash transfer program, targets extremely poor households in which no adult is able to work. The PASP, established in 2012, focuses on extremely poor households in which one or more adults are able to work, but face limited employment opportunities or low income prospects. The PASP is designed to boost incomes among its beneficiaries through direct employment in public works projects, and by providing training programs and other educational opportunities. The first phase of the PASP is currently being implemented and the program will begin scaling up in January of 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 are temporarily vulnerable or have been affected by an acute shock.

**58. Social safety net programs are also being expanded to better serve the poorest and most vulnerable.** The Government has increased the budget allocation for social protection programs. Spending on social protection has almost tripled since 2008, rising from around US\$13 million to an allocation in 2014 of US\$85 million, 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 335,000 as of June 2013. The goal for 2014 is 430,000 households, of which 85 percent will be enrolled in either the PSSB or the PASP. The authorities began to expand the coverage of the PSSB in 2012 with a target of 340,000 for 2014. In 2013 the Government enrolled the first 10,000 households in the initial phase of the PASP; this was funded through a Rapid Social Response Multi-Donor Trust Fund and further expansion of the PASP will begin in 2015.

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<sup>15</sup> Decree n° 52/2011, which created the Basic Social Security Programs to be implemented under the Ministry of Women and Social Action, through the National Institute of Social Action

<sup>16</sup> 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.

**PRSC-10 Prior action 4: The National Institute of Social Action (INAS) has developed and adopted a single registry of beneficiaries for all INAS programs providing cash to beneficiaries**

59. **Implementing effective and well-coordinated social security policies requires an accurate, comprehensive and regularly updated registry of beneficiaries.** With the support of Mozambique's development partners INAS has developed a single registry covering all beneficiaries of basic social assistance programs, starting with those enrolled in the PSSB, PASD and PASP (PRSC-10 prior action) and it has adopted the operations manual for the single registry of beneficiaries. INAS also adopted a revamped targeting process that groups beneficiaries by region, community and household. INAS is now developing a plan for integrating the comprehensive registry of beneficiaries into the Management Information System operated by MPD. The single registry of beneficiaries adopted will be populated with beneficiaries of the three programs by INAS by mid-2015 (PRSC-11 trigger). After that, the system will be ready to be used by the social safety net programs. As a result of the reforms supported INAS will be using the single registry for beneficiaries of the three main Social Protection programs, PASD, PASP and PSSB by the end of the series.

**PRSC-10 Prior action 5: INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the payment distribution system**

60. **To strengthen the efficiency and integrity of social protection programs the Government has approved a plan to partner with private firms to distribute cash benefits (prior action for PRSC-10).** Contracting private firms to execute payments, including banks and telecom companies that operate mobile funds-transfer systems, will help to ensure that cash benefits are timely, predictable, transparent and secure, allowing eligible households to base their financial decisions on reliable expectations and avoid the use of negative coping mechanisms. The Government will begin the process of establishing these partnerships in the second half of 2014. New distribution systems will be piloted, adjusted as necessary, and then integrated into both the PSSB and PASP. INAS has designed the new payment distribution system and is currently conducting an international bidding process to select an appropriate firm or firms. The new system is expected to be operational by 2015. The reform supported provides the basis for a selection of an operator later in the year. With an operator selected and the adoption of the payment system to make payments, by the end of the program the percentage of beneficiaries from PASP and PSSB that are paid within the month will reach at least 50 percent.

### **C. Enhance Public Finance Management**

61. **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. SISTAFE legislation (2002), along with new PFM policies and procedures, provided 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 and the internal oversight coordinating body (Inspeção Geral das Finanças) have been enhanced to increase audit coverage.

### Improving the Management of Audits

**62. In terms of strengthening audit and oversight mechanisms, reforms supported have focused on strengthening internal and external audit follow-ups which was identified in recent PEFA reports as a key weakness.** According to recent PEFA reports, there has been in the past limited management response to audit recommendations. As a result, IGF begun 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 General Inspectorate of Finance (Inspeção Geral de Finanças—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.

**63. There has been significant progress in follow up of audit recommendations as monitored through the PAF used by the G19 for budget support.** As a result of the ongoing policy dialogue between the Government and its development partners, internal audit indicators in the PAF will now monitor 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 2013, 49 percent of all audit recommendations by IGF and the OCIs received appropriate follow up. Until September 2014, 31 percent of all audit recommendations by IGF and the OCIs had received appropriate follow up, and it is expected that until the end of the year 45 percent of all recommendations by IGF and the OCIs as well as 20 percent of all recommendations by the Supreme Audit Institution have had appropriate follow up. During 2014 IGF is designing a risk matrix that will allow authorities not only to monitor the percentage of recommendations being followed up but also to evaluate whether the recommendations that are being followed up are those that entail higher risks. Given the progress so far as well as the close monitoring being provided through the G19, this reform is not included as a prior action in this operation, but the program will continue to monitor progress and to what extent results envisioned are being achieved. It is expected that by the end of the program at least 40 percent of the audit recommendations by OCI and IGF are implemented by the entities audited/ inspected.

### Improving Public Investment Management

**64. 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<sup>17</sup>.

**65. The Government has recognized both the need to strengthen its PIM system and the challenges that must be met.** In March 2011 the Government established the Public Project Coordination and Selection Committee (*Comité de Coordenação e Seleção de Projectos Públicos*, CCSPP), an organ of MPD that advises Government on the prioritization and selection of public investment projects. The CCSPP is chaired by a representative of MPD and includes staff from MoF, BdM and infrastructure-related sector ministries, including the Ministries of Energy, Transportation and Public Works. It is supported by a technical secretariat in the Directorate for Investment and Cooperation in MPD. 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 public investment policy is consistent with long-run debt sustainability.

**PRSC-10 Prior action 6: 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**

**66. The Government has developed a series of tools that will contribute to improved appraisal and evaluation of projects with the help of the Bank.** A recent report prepared by the Bank for the Government of Mozambique on the necessary pillars for a strong Public Investment Management System<sup>18</sup>, 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. The manual was developed with technical support from both the

<sup>17</sup> 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.

<sup>18</sup> World Bank, 2013, "Proposta de melhoria do sistema de investimento público em Moçambique"



World Bank and the IMF and incorporated input from line ministries and provincial authorities. It was adopted by MPD in May 2013 (prior action for PRSC-9).

67. **At the same time, the Government is strengthening the regulatory framework for public project appraisal and evaluation.** MPD and MoF revised their methodology to prepare the Medium Term Fiscal Framework making project appraisal and evaluation mandatory for all public investments in excess of US\$5 million (prior action for PRSC-10). This stronger regulatory framework is crucial to avoid the selection of poor projects for implementation, and it may also slow down the acceleration of public investment over the past few years. A more paced investment program will also provide additional time to strengthen Government capacities for public investment management. Several partners, including the Bank, have been supporting capacity building activities for project appraisal and evaluation in the relevant government agencies. The recently approved 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. The reform supported mandates line ministries to appraise and evaluate public investment projects. This mandate will strengthen MPD and MoF capacity to request that projects be appraised and evaluated. By the end of the program all public investment projects included in the Integrated Investment Program will have been appraised and evaluated.

**PRSC-10 Prior action 7: The Council of Ministers has adopted the *Programa Integrado de Investimentos 2014-2017***

68. **The Government is working to improve public investment prioritization and exploit complementarities between projects through the preparation of the Integrated Investment Program.** To further strengthen the ability of its agencies to appropriately sequence public investments the Government approved the PII and published it late 2013 (prior action for PRSC-10). The preparation of the PII was supported by the Bank and the IMF. The PII attempts to prioritize investments over both the short and medium term based on a 3-year rolling investment program. The objectives of the PII are to (i) improve the country's economic integration, (ii) increase agricultural productivity, (iii) improve logistics and access to markets, (iv) economic diversification, and (v) improved quality of social services infrastructure. The PII identifies two development corridors in the center and north of the country (the Zambezi Valley and the Nacala Corridor) as deserving particular attention, although investments in the PII have a wide geographical distribution and cover most provinces in the country. The PII is revised each year, and updated projections of investment costs and benefits will be used to inform the debt management strategy. A revised PII is currently being prepared, which will include summary information of all investment projects included in the PII. The publication of the PII will be a first step to ensure that at least 90 percent of public investment projects (by value) included in the PII has been appraised and evaluated, contributing to better informed decision making and ultimately better public investment projects being implemented.

69. **Transparency will be crucial to the success of the reformed PIM system.** Transparency in project evaluation and selection is essential not only to enhance the quality of public projects but also to build public confidence in the integrity of the system. Publishing the PII has helped to keep stakeholders in the private sector and civil society informed of the Government's

investment strategy, while also raising awareness of the benefits of individual projects. Project assessments in the PII will be a matter of public record, and the revised PII will include a summary of all approved projects, including information on their expected costs and benefits, main beneficiaries, financing mechanisms and other criteria used during the appraisal and evaluation process (trigger for PRSC-11).

### Improving Public Debt Management

**70. Increasing infrastructure investments without compromising fiscal sustainability will require the Government to strengthen its capacity for debt management, as new investment will be financed largely through borrowing.** In 2013 Mozambique's total public external debt stock was 43.5 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 marginal 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.

**71. 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 Dívida Pública*—CGDP). The CGDP is a consultative and advisory body in MoF; it is coordinated by the National Directorate of the Treasury and includes staff from MoF, MPD 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. These efforts include the Financial Sector Technical Assistance Project, launched in 2005, and the joint Debt Management Facility program.

**72. In September of 2012 the Government adopted an enhanced Medium-Term Debt Management Strategy for 2012-15** (prior action for PRSC-9). This strategy will guide the Government's borrowing practices. It evaluates the current composition of the public debt stock, assesses different financing scenarios according to their costs and associated risks, and analyses prospects for the development of the domestic capital market. The strategy projects a gradual shift in the debt burden in favor of more domestically held debt as the domestic capital market expands, assuming that demand for public debt will continue to increase over the medium term.

**PRSC-10 Prior action 8: The Ministry of Finance has implemented the first annual domestic borrowing plan, prepared based on the medium term debt management strategy**

**73. As part of its efforts to improve debt management, the Government has formulated and implemented during 2013 its first annual domestic borrowing plan** (prior action for PRSC-10). The first annual domestic borrowing plan is designed to improve internal planning and communication between the Government and private capital markets. Following the

experience of 2013, in early 2014 the Government issued the second annual domestic borrowing plan. Other activities to improve debt management include a complete overhaul of MoF debt database and an operations manual to improve data quality and facilitate the management of the country's debt service obligations (still in preparation). In addition, the publication of quarterly debt reports, which began in late-2011, provides up-to-date information on the evolution of public and publicly guaranteed debt, the contracting of new loans, associated cost and risk indicators, and a link to the macroeconomic scenarios underlying the new Medium-Term Debt Strategy. The Government is also planning to revise the Medium Term Debt Management strategy next year (trigger for PRSC-11), to be discussed as part of technical assistance that will be provided by the Bank in December 2014. 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.

**74. 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 and the weaknesses of government systems to manage such fiscal risks. Improved fiscal risks management is now at the center of the dialogue of budget support donors with the Government. 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 latest IMF PSI review suggests that this may already be happening. Contingent liabilities accrued 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 generally not recognized or analyzed in Mozambican budget documents and there is currently no strategy for managing them in a comprehensive manner<sup>19</sup>.

**75. 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 are planning to set up a fiscal risk unit in MoF, which would analyze the implications of government guarantees, public enterprises, and public-private partnerships, and they have asked the Bank to support this effort. Over the medium term this unit would be responsible for preparing a comprehensive statement of fiscal risks to be included in annual budget documents.

**76. The authorities are already taking steps to improve the management of fiscal risks.** While the establishment of a fully functional fiscal risks unit will take time, the authorities are working to strengthen the financial oversight of public enterprises. The Government also plans to disclose all government guarantees, including to whom they are made and the risk exposure they create. A first step in this exercise would be to clarify the scope of the public sector by better defining (i) semi-public entities with varying degrees of legal, administrative and financial

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<sup>19</sup> World Bank, forthcoming, "Mozambique Public Expenditure Review"

autonomy (“*equiparados*”), (ii) State Owned Enterprises (SOEs) and other firms controlled directly by the state, and (iii) indirect public holdings, which occur when an SOE owns shares in a private firm. The Government aims to more clearly delineate the scope of the public sector in 2015 (trigger for PRSC-11).

<b>PRSC-10 Prior action 9: The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012)</b>
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77. **The Government is improving SOE oversight by tightening the legal framework for public enterprises.** In order to better manage fiscal risks generated by public enterprises the Government modernized the legislation governing SOEs in 2012 (Law 6/12 on Public Enterprises), and in December 2013 it approved the implementing regulations (Decree 84/2013) (prior action for PRSC-10). These regulations will greatly improve the Government’s ability to monitor the country’s 14 SOEs, which will now submit their plans, budgets, audited accounts and quarterly reports to MoF. The Government is preparing annual summary reports on SOE operations for the council of ministers, and the increased use of performance-based contracts along with enhanced reporting requirements for SOE subsidies will further strengthen the Government’s ability to monitor fiscal risks. The prior action will provide MoF with the legal basis required to collect better information of SOEs, a potential source of fiscal risks. This, together with efforts to have a more comprehensive understanding of the scope of the public sector and better identifying and managing fiscal risks will result in detailed information and quantification of fiscal risks. By the end of the program the 2016 budget will incorporate detailed information and quantification on fiscal risks.

78. **To enhance the oversight of all public and semi-public enterprises the Government will submit to the council of ministers a draft Law on the Corporate Sector of the State in 2014.** This law will require the disclosure of all direct and indirect financial ties between the Government and these enterprises on an annual basis, including the provision of goods or services at below-market prices or any other quasi-fiscal activities. With technical support from the Bank the Government is also working to consolidate its portfolio of participations in companies over the medium term through privatization, divestiture and liquidation.

## *Analytical Underpinnings*

79. **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.

80. Table 5, below, presents an overview of relevant economic and sector work and its contribution to the proposed operation.

**Table 5: Analytical Underpinnings**

<b>Analytical Reports</b>	<b>Findings and Recommendations</b>	<b>Links to the PRSC Series</b>
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 on Economic Development in the proposed PRSC series reflect some of the constraints to growth that need to be overcome (prior actions 1 and 2)
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 5)
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 action 3)
Mozambique: Prioritizing Infrastructure Investment Using a Spatial Lens (2012) World Bank.	Analyzes different infrastructure-investment scenarios and proposes a methodology for prioritizing capital spending to achieve the greatest employment-growth and poverty-reduction impacts.	Relevant to the PRSCS-supported PARP objectives for promoting increased investment in labor-intensive industries and supporting the development of micro, small and medium enterprises (prior actions 1 and 2)
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 actions 1 and 2)
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 and in particular to the PRSC-supported PARP objectives for improving natural-resource management (prior actions 7, 8, 9 and 10)
Mozambique: Social Protection	Analyzes the current state of social	Relevant to the social assistance

Analytical Reports	Findings and Recommendations	Links to the PRSC Series
Assessment: Review of Social Assistance Programs and Social Protection Expenditures (2011) World Bank (Social Protection)	protection policies in Mozambique and identifies key challenges facing the Government's social assistance strategy.	agenda encompassed under objective 2 of the proposed operation, including the PRSC-supported PARP objectives for expanding social action programs and the protection of vulnerable groups (prior actions 5 and 6)
Mozambique Public Expenditure Review (forthcoming)	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 3 <sup>rd</sup> objective of this operation (prior actions 7, 8, 9 and 10)
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 actions 7 and 8)
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 (trigger for PRSC XI)
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 actions 1 and 2).
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 7, 8, 9 and 10)

### 4.3 LINKS TO THE COUNTRY PARTNERSHIP STRATEGY AND OTHER BANK OPERATIONS

81. **The proposed PRSC-10 is a key element of the Bank's CPS for FY2012-15.** The CPS identifies this PRSC series as the Bank's primary means of supporting the reform program in Mozambique and envisages annual PRSC operations for each year of its implementation. The proposed PRSC-10 is designed to reflect the expanded scope of the current CPS while retaining its focus on developing the strong, supportive economic and regulatory infrastructure necessary to sustain inclusive growth. The PRSC-10 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-10 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.

82. **The PRSC-10 is one of several budget support operations in Mozambique.** The PRSC-10 is prepared in parallel to a Climate Change Development Policy Operation (DPO) (US\$50 million) and an Agriculture DPO (US\$50 million), each of which is also the second annual operation in a series of three and the recently approved Financial Sector DPO (US\$25 million). 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 complements the private sector reforms supported by the proposed PRSC-10, while the Social Protection Project (SPP) directly supports the Government’s efforts to operationalize its social protection strategy. 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 AND COLLABORATION WITH DEVELOPMENT PARTNERS

83. **A Memorandum of Understanding (MoU) was signed in March 2009 between the Government and the G19, which includes the World Bank.** The MoU 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. Implementation of the Paris Declaration and the Accra Agenda for Action is monitored by the G19, the UN agencies and other development partners. The Bank and IMF continue to work together to support the implementation of the PARP, 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. Since 2009 the IMF has been an ex-officio member of the G19, and it will continue to time its missions to correspond to the G-19 joint review meetings.

84. **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 benefited from additional consultations with interested stakeholders, such as the industrial licensing decree or the revised Fiscal Regime for Hydrocarbons. 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 6: Prior actions and Indicative Triggers, PRSCs 9 to 11**

Outcomes Sought	Description of Reforms	PRSC-9 Prior actions	PRSC 10 Prior actions	PRSC 11 Indicative Triggers
<b>Pillar 1: Improve business climate and increase transparency in the management of extractive industries</b>				
<i>Improving Business Regulations and Investment Climate.</i>	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 Government introduces the e-BAU, an integrated IT platform to further streamline business start-up procedures.

<b>Outcomes Sought</b>	<b>Description of Reforms</b>	<b>PRSC-9 Prior actions</b>	<b>PRSC 10 Prior actions</b>	<b>PRSC 11 Indicative Triggers</b>
<i>Improved transparency and management in extractive industries.</i>	Increased transparency and approval of legislation on extractive industries.	Mozambique has achieved compliance with the standards of the Extractive Industries Transparency Initiative (EITI).		Mozambique has achieved compliance with the new and revised standards of the Extractive Industries Transparency Initiative (as approved on May 2013).
		The Council of Ministers has approved the draft Mining Law and has sent it to its National Assembly for approval.		The Council of Ministers approves the implementing regulations for the revised 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 approves the implementing regulations for the revised Hydrocarbons Sector 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 Government revises the system by which it transfers a share of the production taxes to communities and its use based on the experience accumulated.
<b>Pillar 2: Strengthen Social Protection</b>				
<i>Improve Access and Allocation of Social Protection Systems.</i>	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 registers all beneficiaries of the PASP in the Single Registry of Beneficiaries (SRB).
	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	INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the	INAS adopts the formal payment system for all the PASP beneficiaries and all new PSSB beneficiaries.



Outcomes Sought	Description of Reforms	PRSC-9 Prior actions	PRSC 10 Prior actions	PRSC 11 Indicative Triggers	
		social safety net programs.	payment distribution system.		
<b>Pillar 3: Enhance Public Finance Management</b>					
<i>Improve the management of audits, public investment and public debt.</i>	Enhanced quality and effectiveness of audit mechanisms, as reflected in the percentage of recommendations implemented by the entities audited/inspected by the OCI's and IGF.	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.			
	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.	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.	
			The Council of Ministers has adopted the <i>Programa Integrado de Inversiones 2014-2017</i> .		
	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.	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.
				The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012).	The Government clarifies the scope of the public sector, including a better definition of public funds and autonomous entities.

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1 POVERTY AND SOCIAL ASPECTS

85. **The policies supported by this series are expected to have a positive impact on poverty and social indicators as outlined in the next few paragraphs. Reforms to simplify business regulations (prior actions 1 and 2) 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, a significant increase from the number of firms that identified it as a constraint in 2006. There is a wealth of analytical work that suggests that 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)<sup>20</sup>. A recent study on jobs in Mozambique<sup>21</sup> sheds more light on the relatively poor performance of the labor market in Mozambique, arguing that there has been little structural transformation in labor markets and that productivity remains very low across the board. 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. These reforms are also more likely to benefit smaller and medium enterprises that have fewer resources at their disposal to deal with an excessively onerous business environment.

86. **The development of the mining and gas sectors (prior action 3) bring significant opportunities to Mozambique, but much will depend on whether the Government is able to capture a fair share of the rents and how these are used.** This series supports reforms for improved transparency and management in extractive industries. The revised sectoral laws for mining and hydrocarbons as well as the fiscal regimes 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. As discussed in a recent policy note prepared by the Bank<sup>22</sup>, revenues from coal and gas may reach US\$9 billion per year towards 2030, accounting for over 20 percent of all revenues. The extent to which Mozambicans benefit from the development of the mining and hydrocarbons sectors will depend on the use that the Government does of natural resource revenues. Transparency in the use of resources will contribute to a more judicious use of resources and sharing of benefits. Even if the country benefits as a whole, massive investments in relatively small (and often isolated) locations may increase social tensions. Learning from international experience, the Government is working to address the social issues in the extractive industries in an integrated manner supported by technical assistance from the MAGTAP project.

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<sup>20</sup> 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.

<sup>21</sup> Jones, Sam and Finn Tarp, 2012, “Jobs and Welfare in Mozambique”. Background Paper for the World Development Report 2013.

<sup>22</sup> World Bank, 2014, “Generating Sustainable Wealth from Mozambique’s Natural Resource Boom”

**87. The proposed PRSC directly contributes to poverty alleviation through its focus on enhancing the scope, targeting and overall efficacy of social protection programs (prior actions 4 and 5).** Detailed analysis of the social and poverty impact of enhancing social protection programs was 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. This program has therefore potential for significant poverty reduction. The extent to which this potential is realized 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.

**88. Efforts to improve public investment management will have a positive impact on the poor (prior actions 6 and 7).** Mozambique has a relatively high rate of public investment, averaging more than 15 percent of GDP during the past 5 years, and it is projected to remain high over the medium term. PIM 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<sup>23</sup>. Reforms supported will contribute to better appraisal and evaluation of investment projects, including social impact assessments and an identification of potential beneficiaries. Increased transparency in public investment management will also have a positive role by expanding the range of stakeholders that are involved in discussions on the selection and implementation of investment projects (Barma et al., 2012)<sup>24</sup>.

**89. Improved debt and fiscal risks management (prior actions 8 and 9) will contribute to fiscal stability and through it the Government’s ability to continue providing public goods and services.** Improved debt and fiscal management will improve the Government’s ability to maintain macroeconomic and fiscal stability. Debt crises have often led to macroeconomic instability that can hurt 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 a negative impact on the poor. The fiscal adjustment often leads to significant spending cuts across the board, including the provision of public goods and services that benefit the poor such as education, health and social protection.

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<sup>23</sup> 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.

<sup>24</sup> Barma, Naazneen H., Kai-Alexander Kaiser, Tuan Minh Le and Lorena Viñuela, 2012, “Rents to Riches? The Political Economy of Natural Resource-Led Development”. The World Bank.

## 5.2 ENVIRONMENTAL ASPECTS

90. **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. The Ministry for the Coordination of Environmental Affairs (*Ministério para a Coordenação da Acção Ambiental* - MICOA) is the agency responsible for conducting Environmental Impact Assessments. 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 MICOA, however, is limited due to financial and technical capacity constraints.

91. **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. The Bank—in this and other operations—is working to help the Government develop and implement appropriate policies to reinforce the management of natural resources, particularly the extractive industries.

92. **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 MPD 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; (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. As a result, neither specific environmental studies nor environmental impact management measures are anticipated for this operation.

### 5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

93. **Addressing fiduciary concerns and strengthening the Government’s financial infrastructure are essential to this operation.** 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, Mozambique’s PFM system is determined to be adequate to support the PRSC series. 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 MoF’s 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 risen significantly, from 28 in 2010 to 47 in 2012.

94. **Recent PFM assessments conducted in Mozambique confirm significant progress in improving PFM and identify areas in need of strengthening.** A recent IMF assessment<sup>25</sup> 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<sup>26</sup> offers largely similar views, arguing that a continued focus on procurement and the roll-out of e-SISTAFE will also be needed. The Government of Mozambique is seeking to reinvigorate the PFM reform agenda through a forum to be established in 2015 involving key stakeholders (including donors) to coordinate PFM reforms, a stronger emphasis on process and institutional reforms as suggested, and a renewed focus on some of the areas identified (e.g. planning and budgeting, public investment management, fiscal risks and debt management, etc.).

95. **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 recently been approved, 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

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<sup>25</sup> IMF, 2014, “Refocusing the Public Financial Management Strategy”, IMF, Fiscal Affairs Department

<sup>26</sup> EU Delegation to Mozambique, 2014, “2013 PFM Annual Monitoring Report Mozambique”

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.

**96. 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 Government shall ensure that the annual financial statements of the BdM is 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 is in line with the economy's fundamentals<sup>27</sup>. 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.

**97. 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 MPD. 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 *meticaís* to the Transit Account of MoF. 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. The G19 and the Government conduct a yearly flow of funds audit on budget support. As in previous occasions the auditor's opinion on the flow of budget support funds provided during 2013 was unqualified. A group of development partners and Government staff are working together to follow up on some of the recommendations of the report.

**98. 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

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<sup>27</sup> Republic of Mozambique: Staff Report for the 2013 Article IV Consultation, IMF Country Report No. 13/200, July, 2013.

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.

#### 5.4 MONITORING AND EVALUATION

99. **The design of the proposed PRSC is aligned with the General Budget Support Program of the G19.** 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 PARP is monitored through monthly joint steering committee meetings held by the Government and the G19. 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 MPD and INE. INE has just started the next round of the Living Standards Measurement Survey (the last round dates back to 2008/09), and first results are expected toward the end of 2015.

100. **Progress on PRSC indicators will be primarily monitored and evaluated through a set of instruments used by the National Planning System as part of its prescribed M&E role under the PARP.** This includes the annual monitoring of activities and indicator targets through the Economic and Social Plan Evaluation and the Budget Execution Report. 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 of the PARP. In addition, M&E mechanisms for specific indicators related to social protection and private sector development will be encompassed under the World Bank's SPP and the IFC's Investment Climate Program.

#### 6. SUMMARY OF RISKS AND RISK MITIGATION

101. **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.

**102. Although currently stable, Mozambique’s macroeconomic stance could be threatened 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. Current account deficits (after grants), though high, have to date been financed mostly by FDI. But the Government will continue to use external borrowing to finance public investments, and if these investments do not generate an adequate return in terms of increased productivity, rising debt levels could threaten macroeconomic stability. The Government is aware that strengthening public investment management is critical. The proposed operation will contribute to these efforts by supporting reforms in public investment management. Fiscal policy has become expansionary in recent years and public spending is projected to reach 42 percent of GDP in 2014. Current spending levels do not seem sustainable and will require tightening of policy in the near term. The Government has committed to tighten the fiscal stance and reduce public spending to 34 percent of GDP by 2019, as suggested in the “Memorandum of Economic and Financial Policies” included in the latest PSI review completed in June 2014. The 2015 budget prepared by the Government provides evidence of that commitment by reducing spending by 5.5 percentage points of GDP and the after grants deficit by 2.6 percentage points of GDP. Macroeconomic risks are considered moderate; while the fiscal stance has been expansionary, the Government has a track record of prudent macroeconomic policy, a stated commitment of reducing public spending to more moderate levels in the medium term and a proposed 2015 budget which fulfills that commitment.

**103. Weak institutional capacity may slow the implementation of reforms. Institutional capacity risks are considered moderate.** Despite ongoing improvements in the capacity of the public administration, a lack of institutional resources could limit the speed and scope of the reforms supported by the proposed PRSC-10. To mitigate this risk the Bank is providing or plans to provide technical assistance in all areas supported by this operation. Due to these initiatives institutional capacity risks are regarded as moderate.

**104. Elections and 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 substantial.** The political climate in the last two years 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. Political dialogue between the ruling party and the opposition has resulted in mutually agreed-upon revisions to election legislation and recently into a cease-fire agreement, declaring the end of the violent confrontations. Political infighting, however, may threaten policy continuity, slow the implementation of reforms or even undermine macroeconomic stability. These risks are partially mitigated by the Government’s demonstrated commitment to advancing economic reforms and maintaining a prudent macroeconomic stance. Any Government, regardless of the political party that wins the October 2014 elections, would probably engaged with development partners, which still finance about 30 percent of the budget, to discuss any major policy reversals. The likelihood of major policy reversals with a new



Government is therefore limited. Furthermore, the role of civil society in promoting good governance and transparency is expanding, and the Bank is working with the authorities and other donors, including the IMF, to ensure the reform program remains on track. Despite some of these ameliorating factors, political risks are considered substantial given recent events and the start of a new administration.

**105. 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 ranks third among the SSA countries most exposed to droughts, floods and cyclones, and severe natural hazards present threats to public health, food security, and the Government's poverty reduction and human development goals. 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 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.

## ANNEXES

### ANNEX 1: POLICY MATRIX AND RESULTS FRAMEWORK Tenth Poverty Reduction Support Development Policy Financing (PRSC-10) - Mozambique

Outcomes sought in line with CPS Outcomes	PRSC 9 Prior actions	PRSC 10 Prior actions	PRSC 11 Indicative Triggers	Indicator	Baseline 2011	End Program Target (2015)
<b><i>Pillar 1: Improve business climate and increase transparency in the management of extractive industries</i></b>						
<b><i>Improving Business Regulations and Investment Climate.</i></b>	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.	7 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 Government introduces the e-BAU, an integrated IT platform 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.
<b><i>Improved transparency and management in extractive industries.</i></b>	Mozambique has achieved compliance with the standards of the Extractive Industries Transparency Initiative (EITI).		Mozambique has achieved compliance with the <u>new and revised</u> standards of the Extractive Industries Transparency Initiative (as approved on May 2013).	Number of applied EITI principles and criteria.	Zero	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 approves the implementing regulations for the revised Mining Law.	New mining contracts negotiated under the revised legislative framework.	0	2

<b>Outcomes sought in line with CPS Outcomes</b>	<b>PRSC 9 Prior actions</b>	<b>PRSC 10 Prior actions</b>	<b>PRSC 11 Indicative Triggers</b>	<b>Indicator</b>	<b>Baseline 2011</b>	<b>End Program Target (2015)</b>
	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 approves the implementing regulations for the revised Hydrocarbons Sector Law.	New gas contracts negotiated under the revised legislative framework.	0	2
	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 Government revises the system by which it transfers a share of the production taxes to communities and its use based on the experience accumulated.	Percentage of transfers to communities that are executed by communities.	0%	80%
<b><i>Pillar 2: Strengthen Social Protection</i></b>						
<b><i>Improve Access and Allocation of Social Protection Systems.</i></b>		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 registers all beneficiaries of the PASP in the Single Registry of Beneficiaries.	Percentage of beneficiaries registered in the Single Registry of Beneficiaries.	Zero	INAS uses a single registry for beneficiaries of the three main Social Protection Programs: PSSB, PASD and PASP.
	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.	Zero	At least 20,000 direct beneficiaries from the PASP.

<b>Outcomes sought in line with CPS Outcomes</b>	<b>PRSC 9 Prior actions</b>	<b>PRSC 10 Prior actions</b>	<b>PRSC 11 Indicative Triggers</b>	<b>Indicator</b>	<b>Baseline 2011</b>	<b>End Program Target (2015)</b>
	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.	INAS adopts the formal payment system for all the PASP beneficiaries and all new PSSB beneficiaries.	Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due.	Zero	Percentage of payments made to beneficiaries from PASP and PSSB within the month they are due reaches 50 percent.
<b><i>Pillar 3: Enhance Public Finance Management</i></b>						
<b><i>Improve the management of audits, public investment and public debt.</i></b>	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 investments mandatory for all projects in excess of USD 5 million equivalent.	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.	Percent of public investment that has been developed as projects, appraised and evaluated, following the guidelines adopted for project appraisal and evaluation.	Zero	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.

<b>Outcomes sought in line with CPS Outcomes</b>	<b>PRSC 9 Prior actions</b>	<b>PRSC 10 Prior actions</b>	<b>PRSC 11 Indicative Triggers</b>	<b>Indicator</b>	<b>Baseline 2011</b>	<b>End Program Target (2015)</b>
		The Council of Ministers has adopted the <i>Programa Integrado de Inversiones 2014-2017</i> .				
	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.	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.	Quarterly and yearly debt reports published.	The IT system to support the preparation of the database for public debt transactions for the analysis of debt sustainability is not fully functional and the 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.
		The Council of Ministers approved the implementing regulations of the public enterprises law (Law 6/2012).	The Government clarifies the scope of the public sector, including a better definition of public funds and autonomous entities.	Fiscal risk statement in the budgeted.	Budget documentation does not include any information on fiscal risks.	The 2016 budget incorporates detailed information and quantification on fiscal risks.

## ANNEX 2: LETTER OF DEVELOPMENT POLICY



REPUBLIC OF MOZAMBIQUE  
MINISTRY OF PLANNING AND DEVELOPMENT  
OFFICE OF THE MINISTER

Oficio nº 238/MPD/GM/ /2014

Maputo, November 04, 2014

**Subject: Letter of Development Policy for the Tenth Poverty Reduction Support Credit (PRSC 10)**

**Dear Mr. Lundell,**

1. I am writing on behalf of the Government of the Republic of Mozambique to request the Tenth Poverty Reduction Support Credit (PRSC 10) in the amount of US\$ 110 million from the International Development Association (IDA), to support the implementation of country's Action Plan for Poverty Reduction (PARP), which was endorsed by the Council of Ministers in 2011 and will end implementation in 2015.
2. We would like to commend your commitment to supporting our efforts to reduce poverty over the years and your active participation in the group of donors that coordinate their budget support to Mozambique through the G19.
3. The objective of the PARP is to combat poverty and promote a culture of work, with a view of achieving inclusive economic growth and reducing poverty and vulnerability in Mozambique. 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. These objectives will contribute to the achievement of PARP objectives and help Mozambique end extreme poverty and promote shared prosperity.

To:  
**Mr. Mark Lundell**  
**Country Director for**  
**Mozambique, Madagascar, Mauritius, Comoros e Seychells**  
**The World Bank**  
**Maputo**

A handwritten signature in black ink, appearing to be 'S' followed by a flourish.

4. The PRSC ID has been designed within the context of the Memorandum of Understanding (MoU) between the Government of the Republic of Mozambique and the international aid partners, including the World Bank Group, signed in March 2009. The MoU outlines the participant's approach to the provision of budget support, among other related measures.

### Macroeconomic context

5. Mozambique's economy remains robust, with growth estimated at 7.4 percent in 2013 and at 6.9 percent in the second quarter of 2014, supported by the expansion of agriculture, extractive industries and services sectors. The economy recovered from the devastating floods in early 2013. Extractive industries continue to be the most dynamic sector in the economy, although growth has moderated in 2014, affected by weaker commodity prices and infrastructure constraints. Agriculture continues to be the economy's largest sector at 28 percent of GDP and it employs 80 percent of the labor force. We expect developments in the mining and petroleum sectors to transform Mozambique's economy in the medium term, with coal production and exports, the implementation of large infrastructure investments, including in LNG plants, greater dynamism in the construction and transport sectors as well a revival of agricultural growth to contribute to annual growth of 7-8 percent.
6. Year on year inflation at the end of 2013 was 3 percent. By August 2014 it had declined to 1.8percent. Low inflation and a weak external environment enabled the Central Bank to ease monetary policy and policy rates are at a record low of 8.25 percent. These efforts have had limited impact on market rates that remain high. Credit growth has accelerated only slowly given a weak monetary transmission mechanism. We expect inflation between 5 and 6 percent of GDP 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.
7. Regarding fiscal policy, tax revenues have grown at a rapid pace, rising from 17 percent of GDP in 2011 to a projected 23 percent in 2014, reflecting efforts to improve tax administration and high capital gains taxes from the emerging extractives industries. This increase in domestic resources has compensated for a decline in aid flows, which in 2013 financed less than 30 percent of expenditures. Public spending reached 35 percent of GDP in 2013 and is projected at 43 percent in 2014. The increase in spending is a result of a number of one-off expenditures (around 3 percent of GDP) such as post-floods reconstruction, the 2014 general elections as well as large investments in defense equipment. Capital spending has also increased significantly over the past few years as we try to close the huge infrastructure gap in the country. The recent reforms to the electoral bodies, part of discussions held with opposition party Renamo to end a violent conflict, also had fiscal implications that needed to be accommodated in the 2014 budget. To be able to accommodate these additional costs as well as additional revenue from capital gains taxes parliament passed a revised

budget in August 2014. The overall deficit (after grants) in 2014 will be 10 percent of GDP. The Government is aware that this high deficit is not sustainable and will be tightening fiscal policy starting in 2015.

8. The new government will prepare a budget and submit it to parliament early next year. We have prepared a budget proposal to inform deliberations of the next government. In this budget proposal, in 2015 government revenue would decline to 25 percent of GDP and we expect grants in the order of 4 percent of GDP. Expenditure would decline as a share of GDP to 37 percent, resulting in an overall balance after grants of 7.9 percent of GDP, which represents a decline of 2.1 percentage points of GDP. This consolidation effort will be possible due to the end of one-off expenditures in 2014, growth in investments and recurrent spending that is slower than nominal GDP and concerted efforts to contain wage bill increases. At the same time, the government is seeking to accommodate additional activities to strengthen the peace agreement reached in 2014 with significant fiscal implications. Going forward, we will continue with efforts to contain public spending growth and we would expect spending to fall to 35 percent of GDP by 2017, resulting in an overall balance (after grants) of 6.4 percent of GDP. These efforts will ensure that the country maintains fiscal and macroeconomic stability which has been one of the cornerstones of our positive growth trajectory over the past few decades.
9. Over the past few years we have also seen a significant widening of the current account deficit, as the country benefited from significant FDI inflows. A large share of these inflows was destined for extractive industries, which by nature are often capital- and import intensive. The current account deficit widened to US\$6 billion in 2013 or 39 percent of GDP. We expect the deficit to widen in the next few years to around 45 percent of GDP, as we continue to benefit from large FDI inflows and invest in developing the country's extractive industries and ancillary infrastructure. As the construction phase comes to an end and exports of mining and gas accelerate toward the end of the decade, we expect the current account deficit to quickly narrow. Despite this large deficit, the balance of payments has been positive over the past few years and our reserve position continues to improve, with reserves reaching US\$3.2 billion by end 2013, or over 4 months of imports (excluding mega project imports).
10. Mozambique has dramatically increased infrastructure investments over the past few years and now has one of the highest investment levels in Africa. These investments will allow us to grow faster in the future and ensure that the benefits of growth are widely shared among the population. A share of this scaling up in investment has been financed by debt. As a result, public debt has grown over the past few years, from 37 percent of GDP in 2011 to 52 percent in 2013. A growing share of this debt was contracted on non-concessional terms for projects that will generate significant financial returns. Debt remains sustainable, as suggested in the latest joint WB-IMF debt sustainability analysis (DSA) for Mozambique prepared in mid-2014, although the risk rating has increased from low to moderate. We expect the rate of growth of debt to decline in the near term, as we moderate the increase in borrowing. In addition, we are strengthening systems to manage a



more complex financing mix and public investment portfolio, and some 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 that will continue to guide our interventions until 2015. The PARP aims to induce patterns of inclusive growth by increasing the allocation of funds for investment under the following pillars: (i) enhancing production and productivity in agriculture and fishing; (ii) creating employment; and (iii) enhancing social and human development. A review of its quantified indicators is underway to refine them, make them more relevant for assessing progress toward strategic aims, and ensure that they are all measurable and adequate for the new development challenges.
12. Enhancing production and productivity in agriculture. Agriculture employs 78 percent of the economically active population and contributes 23 percent to GDP. Thus 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 just launched an agricultural investment plan (PNISA) 2013-17 that will help to gradually shift production from subsistence to commercial farming. We have also introduced new regulations for the production of seeds and fertilizers. As a result, we have seen significant progress in our objective of increasing agricultural productivity. During 2013 15 percent of farmers were assisted by extension services to adopt new technologies. The area with rehabilitated irrigation infrastructure reached 5,800 ha and 73 percent of all roads are considered to be in good condition.
13. 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 adopted a new strategy for the Improvement of the Business Environment 2013-17 (EMAN II) and are working with a series of development partners, including the World Bank Group, to implement the interventions included in this strategy. We have recently approved a long term development strategy for the country (Estratégia Nacional de Desenvolvimento) which seeks to guide development in Mozambique over the next 20 years to improve the wellbeing of the population through structural transformation and expansion and diversification of the productive base. As a result of these efforts we have continued to strengthen vocational training and improved opportunities for SMEs in public tenders. In all, 270,267 formal sector jobs were created: 92,140 in the public sector and 178,127 in the private sector.
14. 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 77 percent. Significant strides in this regard have been the creation of an increasingly gender-equitable system, particularly in secondary schools, and progress in monitoring and evaluating student performance in primary schools. In the health sector, the 2012-16 Health Strategy and the Monitoring and Evaluation plans

were adopted recently, which aim to push forward improvements in the still relatively weak public health system. We launched the Action Plan for Pharmaceutical Logistics and finalized the Pharmaceutical Logistics Strategy as a means to deal with the drug logistics crisis and emergency that had arisen in 2011. PFM systems in the sector have also strengthened with bi-monthly monitoring of the sector accounts. Development outcomes show some progress across a range of sectors, including an increase of assisted deliveries from 65 to 69 percent, an increase in the number of households benefitting from social assistance from 344,000 to 365,000 as well as an increase in the number of water sources in rural areas from 19,000 to over 23,000.

#### **Recent and planned reforms in this operation**

15. 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: (i) to foster economic development, (ii) to strengthen social protection and (iii) to improve public finance management. The specific reforms implemented over the last year include:

#### ***Economic Development – Investment Climate***

16. 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 that will reduce the number of days that businesses need to obtain these licenses as well as the administrative costs associated with the process. In 2014 we have revised the industrial licensing regulations which will dramatically reduce the amount of time required to issue industrial licenses. In 2014 we have also adopted a single form for opening a new business and starting activities. The single form consolidates a number of processes that were formerly separate, and private firms may now submit all required information at the government's "one-stop shop" for business registration. This is expected to cut by half the number of steps required for regulatory compliance. The One-stop shops are being piloted in six Mozambican cities and we expect it to be expanded to the rest of the country next year.

#### ***Economic Development – Management of Extractive Industries***

17. 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. The debate around these pieces of legislation has been very lively and the legislation passed reflects the compromises that have been reached to bring the maximum benefit to the people of Mozambique. In the next few

months we need to pass implementing regulations for the mining and petroleum law as well as prepare a decree law that will govern LNG investments and operations in the Rovuma basin. This legislation will pave the way for final investment decisions by investors in the Rovuma basin and the start of the LNG plants construction.

18. We are also aiming to maximize transparency in the way the country manages extractive industries. We remain compliant with the EITI, the last report was published in March 2014 and we will increase our efforts to ensure that the next report, to be published by the end of 2014, confirms our compliance with the new EITI status. The majority of contracts with investors in the extractive industries were also made public online at the beginning of this year 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 2013 we allocated 2.75 percent of production taxes to seven producing districts. We continued with these transfers in 2014. The transferred amounts are to be used by communities to invest in community infrastructure such as schools, health centers, markets or bridges. As this is a new initiative and the country has had to tackle significant volatility in the volumes of production and prices of its extractive industries, there have been some delays in the transfers and execution of projects. We have been working with your institution to better understand the strengths of this initiative and how it can be improved and we expect to make the necessary adjustments in the near future to ensure affected communities continue to benefit from these transfers.

### ***Social Protection***

19. 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, but we still have some work to do. As we continue to allocate additional resources to these key programs, we will need to establish more effective mechanisms for selecting, recording and organizing beneficiaries in order to allocate and manage funds effectively.
20. Recognizing these challenges, the government has launched a comprehensive initiative to strengthen the legal and institutional framework for social protection. The Social Protection Law, passed in 2007, establishes the legal foundation and institutional structure for the social protection system. In 2009 the government launched the National Strategy for Basic Social Security (Estratégia Nacional de Segurança Social Básica—ENSSB). The government is currently working to evaluate and to design the new ENSSB which include possibility to indicate new programs. The Basic Social Subsidy Program (Programa de Subsídio Social Básico—PSSB), a cash transfer program, targets extremely poor households in which no adult is able to work. The Productive Social Action

Program (Programa de Acção Social Productiva—PASP), focuses on extremely poor households in which one or more adults are able to work, but face limited employment opportunities or low income prospects. The PASP is designed to boost incomes among its beneficiaries through direct employment in public works projects, and by providing training programs and other educational opportunities.

21. The PSSB and the PASP would provide support to about 800,000 extremely poor vulnerable households in rural and urban areas once full implementation was reached. The first phase of the PASP is currently being implemented and the program will begin scaling up in January of 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 are temporarily vulnerable or have been affected by an acute shock. The government has increased the budget allocation for social protection programs. Spending on social protection has almost tripled since 2008, rising from around US\$13 million to an allocation in 2014 of US\$85 million, or 0.5 percent of GDP.
22. 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. Implementing effective and well-coordinated 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, PASD and PASP. INAS also adopted a revamped targeting process that groups beneficiaries by region, community and household. The single registry of beneficiaries will be fully functional next year, after INAS has registered all potential beneficiaries, and the system will be ready to be used by the social safety net programs next year.
23. To strengthen the efficiency and integrity of social protection programs the government will partner with private firms to distribute cash benefits. Contracting private firms to execute payments, including banks and telecom companies that operate mobile funds-transfer systems, will help to ensure that cash benefits are timely, predictable, transparent and secure. The government has already designed the new payment distribution system and launched a tender to select an appropriate operator. The new system is expected to be operational by 2015 and result in a significant increase in the share of beneficiaries that receive their payments on time.

### ***Public Finance Management***

24. 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 and that we are able to reinvest rents from the

extractive industries and transform natural capital into physical and human capital, laying the foundation for robust economy-wide growth.

25. As we continue with our efforts to close the large infrastructure gap to remain competitive and ensure widespread enjoyment of the benefits of growth, we are increasing efforts to strengthen our systems to manage public investments to ensure the implemented projects have the expected returns. As part of these efforts the Government last year adopted the Integrated Investment Program (Programa Integrado de Investimento—PII). The PII will strengthen the ability of government agencies to appropriately sequence public investments by prioritizing investments over both the short and medium term based on a 3-year rolling basis. The objectives of the PII are to (i) improve the country's economic integration, (ii) increase agricultural productivity, (iii) improve logistics and access to markets, (iv) economic diversification, and (v) improved quality of social services infrastructure. The PII is revised each year, and updated projections of investment costs and benefits will be used to inform the debt management strategy and the medium term fiscal framework. A revised PII is currently being prepared, which will include summary information of all investment projects included in the PII. The PII also improves transparency in the decision making process by making public the type of information that has led to public investment decisions. The PII will also keep stakeholders in the private sector and civil society informed of the government's investment strategy, while also raising awareness of the benefits of individual projects.
26. As part of our efforts to improve our public investment management systems, we are also strengthening institutional structures, methodologies to appraise and evaluate projects and building the capacity of our staff. In March 2011 the government established the Public Project Coordination and Selection Committee (Comité de Coordenação e Seleção de Projectos Públicos, CCSP), an organ of the Ministry of Planning and Development that advises government on the prioritization and selection of public investment projects. The CCSP is chaired by a representative of MPD and includes staff from MoF and infrastructure-related sector ministries. 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. MPD and MoF recently revised the methodology to prepare the Medium Term Fiscal Framework making project appraisal and evaluation mandatory for all public investments in excess of US\$5 million. We have conducted a series of capacity building workshops over the past few years to build the capacity of government staff in project appraisal and evaluation and intend to continue doing so. The recently approved Mozambique Integrated Growth Poles Project from the World Bank 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. This is a long-term reform that will change in fundamental ways how we operate, and we look forward to continue working with your institution as we continue to implement this reform.
27. We are also seeking to strengthen our ability to manage debt and fiscal risks, as a large share of the new infrastructure investments are being financed through debt or financing mechanisms that

may increase fiscal risks. Improved management of debt and fiscal risks will allow us to continue implementing our ambitious infrastructure investment plan without compromising fiscal sustainability. In March 2011 the government established the Public Debt Management Committee (Comité de Gestão da Dívida Pública—CGDP). The CGDP is a consultative and advisory body in MoF; it is coordinated by the National Directorate of the Treasury and includes staff from MoF, MPD and BdM. The World Bank and IMF are providing technical assistance to the government to improve its debt management capacity. These efforts include the Financial Sector Technical Assistance Project, launched in 2005, and the joint Debt Management Facility program. We prepared our own Debt Sustainability Analysis in 2011, supported by both IMF and World Bank staff, an exercise we repeated in of 2012. We also adopted in 2012 an enhanced Medium-Term Debt Management Strategy for 2012-15, will guide the government's borrowing practices.

28. As part of our efforts to improve debt management, we formulated our first annual domestic borrowing plan in 2013 which we have successfully implemented. This will improve internal planning and communication with private capital markets. Following the experience of 2013, in early 2014 we issued the second annual domestic borrowing plan. We have also improved transparency and communication through the issuance of quarterly debt reports, which began in late-2011. We will revise the Medium Term Debt Management strategy next year.
29. As we seek to finance a share of infrastructure investment in partnership with the private sector, through PPPs or investments by SOEs, we will have a more complex financing mix which we will need to manage. Improved fiscal risks management is one of the areas that we will focus on in the near future, as suggested by the Fiscal Transparency Assessment that we asked the IMF to conduct in 2013. This assessment will inform the reform program going forward. We also recognize that the type of information in budget documentation on fiscal risks could be improved, which we will seek to do in the medium term. Our efforts will be supported by the establishment of a new fiscal risks unit in the Ministry of Finance. We are working with your institution for the design of this new unit, but we expect the new unit to, among other responsibilities, analyze the implications of government guarantees, public enterprises, and public-private partnerships. Over the medium term this unit would be responsible for preparing a comprehensive statement of fiscal risks to be included in annual budget documents. We are also working to strengthen the financial oversight of public enterprises and passed legislation and implementing regulations to that effect recently. We are also preparing a new law to govern the corporate sector of the state which we expect to send to parliament next year.

#### **Activities undertaken in 2014**

30. The PRSC-10 will support the following prior actions already completed by the Government of Mozambique to achieve results in the reform aims discussed above:
- a) The Council of Ministers has approved the Industrial Licensing Decree
  - b) The government has issued a decree adapting the single form for opening a new business and starting activities

- c) The Council of Ministers has approved a draft Fiscal Regime for the Hydrocarbons Sector and submitted it to the National Assembly
- d) INAS has developed and adopted a single registry of beneficiaries for all INAS programs providing cash as benefits
- e) INAS has designed a new payment distribution system and launched a tender to select an appropriate operator for the payment distribution system.
- f) 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 project appraisal and evaluation mandatory for all public investments in excess of US\$5 million.
- g) The government of Mozambique has adopted and published the Integrated Investment Program
- h) The Ministry of Finance has completed, published and implemented the first annual domestic borrowing plan based on the Medium-Term Debt Management Strategy
- i) The Council of Ministers has approved the implementing regulations for the Law on Public Enterprises

### Prospects for 2015

31. Next year, we also expect to complete a number of policy actions that will further reforms in the areas covered by this operation. The policy actions that we expect to complete in 2015 are the following:
- 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 revised Mining Law
  - d) The Council of Ministers approves the implementing regulations for the revised Hydrocarbons Sector 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 all beneficiaries of the PASP in the Single Registry of Beneficiaries (SRB).
  - g) INAS adopts the formal payment system for all the PASP beneficiaries and all new PSSB beneficiaries.
  - h) 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.
  - i) 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.
  - j) The government clarifies the scope of the public sector, including a better definition of public funds and autonomous entities.

## **Conclusion**

32. To conclude, we would like to highlight 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-ID to support recent and planned reforms in the financial sector which seek to promote the development of a sound, diverse, competitive, and inclusive financial sector.

Yours sincerely



**Aiuba Cuereineia**  
**Minister of Planning and Development and**  
**Governor for Mozambique**

**C.c:**  
**H.E. Manuel Chang**  
**Minister of Finance**

**H.E. Ernesto Gove**  
**Governor of Bank of Mozambique**



## ANNEX 3: IMF RELATIONS NOTE

### IMF Staff Concludes Review Mission to Mozambique, Calls for Fiscal Prudence, More Inclusive Growth, and Greater Public Investment Transparency

Press Release No. 14/502  
November 5, 2014

A staff team from the International Monetary Fund (IMF), led by Doris Ross, visited Mozambique during October 22–November 6, 2014 to hold discussions towards the completion of the third review under the three-year Policy Support Instrument (PSI) <sup>1</sup> approved in June 2013 (see [Press Release No. 13/231](#)). The team met with President-elect Filipe Nyusi, Finance Minister Manuel Chang, Planning and Development Minister Aiuba Cuereneia, Bank of Mozambique Governor Ernesto Gove, other line ministers, senior government officials, the private sector, civil society, and development partners. It also met with the presidential candidates of the three main parties. The team traveled to Tete, where it met with Governor Paulo Auade and got acquainted with the main economic challenges facing a region that exemplifies the importance of developing extractive industries while creating jobs and economic opportunities for the population, including in agriculture.

At the conclusion of the visit, Ms. Ross issued the following statement:

“Mozambique’s economic performance remains robust. Real Gross Domestic Product (GDP) growth is projected at 7.5 percent in both 2014 and 2015, reflecting strong activity in all sectors, especially extractive industries, construction, transport and communication, commerce and financial services. Risks to this outlook have increased somewhat recently with the decline in commodity prices in world markets, especially for coal, and uncertainty about the large Liquefied Natural Gas (LNG) projects. While substantial natural resource revenues are 6–10 years away, efforts are needed to put in place adequate institutional arrangements and capacity to address the large new challenges associated with this sector and the promise it holds for the country.

“Inflation remains well-contained thanks to an increase in domestic food production and a decline in import prices. Average inflation stood at just 1.4 percent in September, well below the same period last year, and is expected to remain below 3 percent for 2014 as a whole. The external current account deficit is large due to imports for big investment projects financed by foreign direct investment (FDI). International reserve coverage seems broadly adequate.

“Recent program performance is mixed. The mission urged the authorities to step up implementation of key structural reforms, especially in the public financial management (PFM) area, financial system and market development. A focus on rural infrastructure development and further improvements in the business environment should help make growth more inclusive by enhancing agricultural productivity and job creation in the private sector.

“Regarding economic policies for the rest of 2014 and 2015, the staff team and the authorities agreed on the need to maintain revenue efforts and slow the growth of public spending, including the wage bill, goods and services and investment while enhancing the efficiency of spending, in order to preserve debt sustainability in the medium term. While the 2015 budget should begin to narrow the fiscal deficit, this should be achieved in a manner that protects social spending such as basic health and education, and social assistance programs.

“The authorities are appropriately committed to (i) further strengthening their management of public resources, including by adopting a fiscal rule to improve the management of windfall revenue; (ii) enhancing the transparency and efficiency of public investment; and (iii) strengthening the management of public enterprises and disclosing the audited annual reports of the largest ones, including the Mozambican Tuna Company (EMATUM). As economic challenges become more complex, the authorities should continue to sharpen their tools to monitor and guide macroeconomic developments.

“The Bank of Mozambique’s commitment to keep money growth in check is welcome and will help to moderate the recent rapid pace of credit expansion to more prudent levels. Real interest rates in Mozambique are still high by international standards, and reforms should address the underlying structural factors to make financial markets more flexible, and thus reduce borrowing cost.

“On return to Washington D.C., the team will prepare a staff report that, upon management approval, is scheduled for discussion by the Executive Board in early January 2015.

“We would like to thank the authorities for the constructive policy discussions during this period of political transition and for their warm hospitality.”

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<sup>1</sup> PSI is an instrument of the IMF designed for countries that do not need balance of payments financial support. The PSI helps countries design effective economic programs that, once approved by the IMF's Executive Board, signal to donors, multilateral development banks, and markets the Fund's endorsement of a member's policies (see <http://www.imf.org/external/np/exr/facts/psi.htm>). Details on Mozambique’s PSI program are available at <http://www.imf.org/mozambique>.

## ANNEX 4: MOZAMBIQUE AT A GLANCE

### Mozambique at a glance

9/3/14

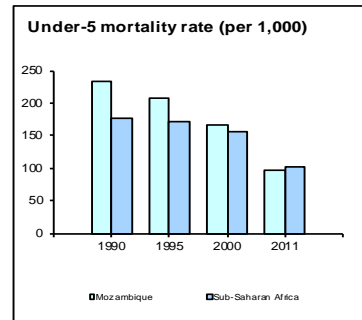
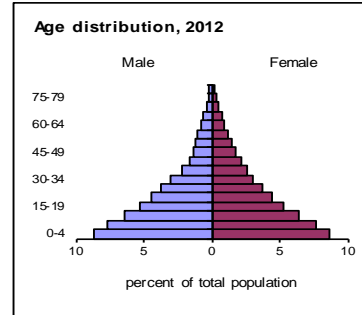
#### Key Development Indicators

(2012)

	Mozambique	Sub-Saharan Africa	Low income
Population, mid-year (millions)	25.2	910	846
Surface area (thousand sq. km)	799	24,262	16,198
Population growth (%)	2.5	2.7	2.3
Urban population (% of total population)	31	37	28
GNI (Atlas method, US\$ billions)	12.9	1,225	494
GNI per capita (Atlas method, US\$)	510	1,345	584
GNI per capita (PPP, international \$)	1,020	2,247	1,387
GDP growth (%)	7.4	4.2	5.9
GDP per capita growth (%)	4.7	1.5	3.6

(most recent estimate, 2005–2012)

Poverty headcount ratio at \$1.25 a day (PPP, %)	60	48	48.3
Poverty headcount ratio at \$2.00 a day (PPP, %)	82	70	74.3
Life expectancy at birth (years)	50	56	61
Infant mortality (per 1,000 live births)	63	64	56
Child malnutrition (% of children under 5)	16	21	22
Adult literacy, male (% of ages 15 and older)	71	69	69
Adult literacy, female (% of ages 15 and older)	43	51	54
Gross primary enrollment, male (% of age group)	110	104	111
Gross primary enrollment, female (% of age group)	100	96	106
Access to an improved water source (% of population)	49	63	67
Access to improved sanitation facilities (% of population)	21	30	37

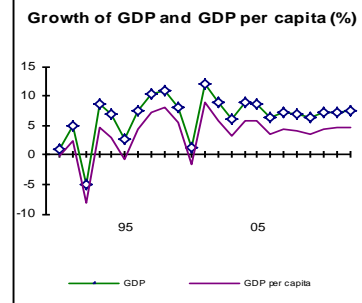


#### Net Aid Flows

	1980	1990	2000	2012 <sup>a</sup>
(US\$ millions)				
Net ODA and official aid	167	998	906	1,952
Top 3 donors (in 2010):				
United States	9	62	116	278
European Union Institutions	7	81	79	192
Portugal	..	43	33	113
Aid (% of GNI)	4.7	43.0	22.9	20.6
Aid per capita (US\$)	14	74	50	81

#### Long-Term Economic Trends

Consumer prices (annual % change)	4.2	43.7	12.7	2.1
GDP implicit deflator (annual % change)	4.1	34.1	12.0	3.0
Exchange rate (annual average, local per US\$)	32.4	947.5	15,689.5	28,373.0
Terms of trade index (2000 = 100)	87	112	100	108



	1980–90	1990–2000	2000–12
Population, mid-year (millions)	12.1	13.6	18.3
GDP (US\$ millions)	3,526	2,463	4,183
	(% of GDP)		
Agriculture	37.1	37.1	24.0
Industry	34.4	18.4	24.5
Manufacturing	..	10.2	12.2
Services	28.5	44.5	51.5
Household final consumption expenditure	96.7	92.3	80.6
General gov't final consumption expenditure	12.2	13.5	9.0
Gross capital formation	7.6	22.1	31.0
Exports of goods and services	10.9	8.2	16.5
Imports of goods and services	27.4	36.1	37.0
Gross savings	-6.9	2.1	13.8
	(average annual growth %)		
	1.1	3.0	2.7
	-0.1	6.1	7.5
	6.6	5.2	7.6
	-4.5	12.3	7.8
	..	10.2	6.9
	6.5	5.0	7.9
	-1.2	5.8	5.8
	-6.7	3.2	9.3
	4.1	8.6	7.5
	-6.8	13.1	13.7
	-3.8	7.6	8.3

Note: Figures in italics are for years other than those specified. .. indicates data are not available.

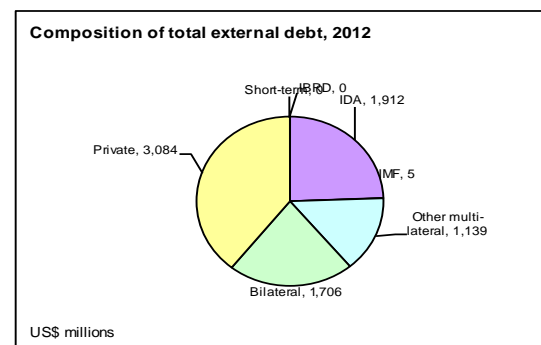
<sup>a</sup>. Aid data are for 2010.

Development Economics, Development Data Group (DECDG).

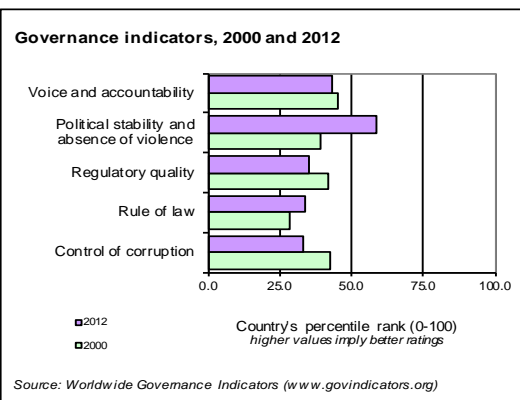
Balance of Payments and Trade	2000	2012
<i>(US\$ millions)</i>		
Total merchandise exports (fob)	364	3,470
Total merchandise imports (cif)	1,163	6,331
Net trade in goods and services	-819	-5,908
Current account balance	-697	-5,189
as a % of GDP	-16.7	-36.4
Personal transfers and compensation of employees (receipts)	37	157
Reserves, including gold	745	2,799
<b>Central Government Finance</b>		
<i>(% of GDP)</i>		
Current revenue (including grants)	15.2	25.6
Tax revenue	10.5	20.0
Current expenditure	11.7	19.4
Overall surplus/deficit	-8.4	-7.4
Highest marginal tax rate (%)		
Individual	20	32
Corporate	35	32

**External Debt and Resource Flows**

<i>(US\$ millions)</i>		
Total debt outstanding and disbursed	7,258	7,846
Total debt service	166	612
Debt relief (HIPC, MDRI)	3,085	1,437
Total debt (% of GDP)	173.5	55.1
Total debt service (% of exports)	21.6	19.5
Foreign direct investment (net inflows)	139	1,340
Portfolio equity (net inflows)	0	1



Private Sector Development	2000	2012
Time required to start a business (days)	-	13
Cost to start a business (% of GNI per capita)	-	19.7
Time required to register property (days)	-	42
Ranked as a major constraint to business (% of managers surveyed who agreed)	2000	2012
n.a.	..	..
n.a.	..	..
Stock market capitalization (% of GDP)	..	..
Bank capital to asset ratio (%)	8.2	9.0



Technology and Infrastructure	2000	2011
Paved roads (% of total)	18.7	20.8
Fixed line and mobile phone subscribers (per 100 people)	1	33
High technology exports (% of manufactured exports)	9.0	26.5

**Environment**

Agricultural land (% of land area)	61	63
Forest area (% of land area)	52.4	49.4
Terrestrial protected areas (% of land area)	14.8	15.8
Freshwater resources per capita (cu. meters)	5,192	4,080
Freshwater withdrawal (billion cubic meters)	..	..
CO2 emissions per capita (mt)	0.07	0.12
GDP per unit of energy use (2005 PPP \$ per kg of oil equivalent)	1.3	2.0
Energy use per capita (kg of oil equivalent)	392	415

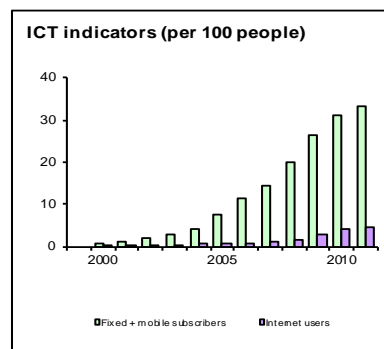
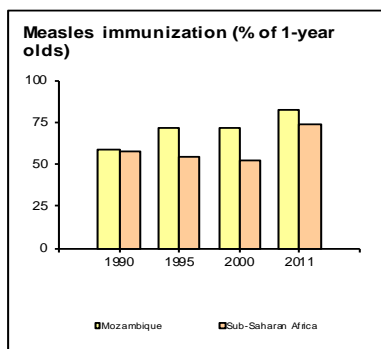
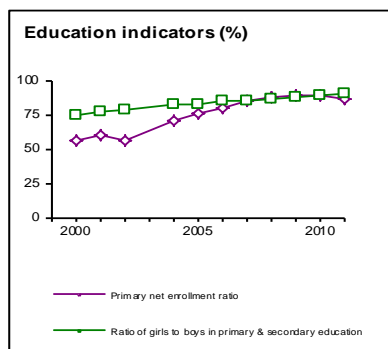
World Bank Group portfolio	2000	2011
<i>(US\$ millions)</i>		
<b>IBRD</b>		
Total debt outstanding and disbursed	0	0
Disbursements	0	0
Principal repayments	0	0
Interest payments	0	0
<b>IDA</b>		
Total debt outstanding and disbursed	760	1,912
Disbursements	125	291
Total debt service	6	10
<b>IFC (fiscal year)</b>		
Total disbursed and outstanding portfolio of which IFC own account	99	70
Disbursements for IFC own account	49	25
Portfolio sales, prepayments and repayments for IFC own account	3	21
<b>MIGA</b>		
Gross exposure	114	152
New guarantees	74	9

Note: Figures in italics are for years other than those specified.  
.. indicates data are not available. - indicates observation is not applicable.

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With selected targets to achieve between 1990 and 2015  
(estimate closest to date shown, +/- 2 years)

	Mozambique			
	1990	1995	2000	2011
<b>Goal 1: halve the rates for extreme poverty and malnutrition</b>				
Poverty headcount ratio at \$1.25 a day (PPP, % of population)	..	80.6	..	59.6
Poverty headcount ratio at national poverty line (% of population)	..	69.4	..	54.7
Share of income or consumption to the poorest quintile (%)	..	5.6	..	5.2
Prevalence of malnutrition (% of children under 5)	..	23.9	23.0	15.6
<b>Goal 2: ensure that children are able to complete primary schooling</b>				
Primary school enrollment (net, %)	44	44	56	86
Primary completion rate (% of relevant age group)	27	26	16	53
Secondary school enrollment (gross, %)	7	7	6	26
Youth literacy rate (% of people ages 15-24)	..	47	..	67
<b>Goal 3: eliminate gender disparity in education and empower women</b>				
Ratio of girls to boys in primary and secondary education (%)	73	69	75	90
Women employed in the nonagricultural sector (% of nonagricultural employment)	11	..	..	..
Proportion of seats held by women in national parliament (%)	16	25	30	39
<b>Goal 4: reduce under-5 mortality by two-thirds</b>				
Under-5 mortality rate (per 1,000)	233	208	166	96
Infant mortality rate (per 1,000 live births)	155	139	112	67
Measles immunization (proportion of one-year olds immunized, %)	59	71	71	82
<b>Goal 5: reduce maternal mortality by three-fourths</b>				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1,300	1,100	870	540
Births attended by skilled health staff (% of total)	..	44	..	54
Contraceptive prevalence (% of women ages 15-49)	..	6	..	12
<b>Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases</b>				
Prevalence of HIV (% of population ages 15-49)	0.4	4.7	9.0	11.3
Incidence of tuberculosis (per 100,000 people)	401	478	513	548
Tuberculosis case detection rate (% , all forms)	29	23	23	34
<b>Goal 7: halve the proportion of people without sustainable access to basic needs</b>				
Access to an improved water source (% of population)	34	37	41	49
Access to improved sanitation facilities (% of population)	9	11	14	20
Forest area (% of land area)	55.2	53.8	52.4	49.4
Terrestrial protected areas (% of land area)	14.8	14.8	14.8	15.8
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1
GDP per unit of energy use (constant 2005 PPP \$ per kg of oil equivalent)	0.9	1.0	1.3	2.0
<b>Goal 8: develop a global partnership for development</b>				
Telephone mainlines (per 100 people)	0.4	0.4	0.5	0.4
Mobile phone subscribers (per 100 people)	0.0	0.0	0.3	32.8
Internet users (per 100 people)	0.0	0.0	0.1	4.3
Households with a computer (%)	..	..	0.2	5.3



Note: Figures in italics are for years other than those specified. .. indicates data are not available.

9/3/14