



## AFRICAN DEVELOPMENT FUND

### PROGRAM: GROWTH AND PUBLIC SECTOR EFFICIENCY (GPSE) PROGRAM

### COUNTRY: MOZAMBIQUE

## APPRAISAL REPORT

*Date: 8 August 2011*

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## Currency Equivalents (as of May 2011)

Mozambican Currency Unit	=	New Mozambique Metical (MZN)
1 Unit of Account (UA)	=	MZN 49.17
1 Unit of Account (UA)	=	US\$ 1.62
1 USD	=	MZN 30.34

## Fiscal Year

January 1 - December 31

## Acronyms and Abbreviations

ADF	African Development Fund	MDG	Millennium Development Goal
AfDB	African Development Bank	MFI	Microfinance Institution
ANEP	National Professional Training Authority	MF	Ministry of Finance
CPAR	Country Procurement Assessment Review	MoU	Memorandum of Understanding
CPIP	Country Portfolio Improvement Plan	MPD	Ministry of Planning & Development
CSP	Country Strategy Paper	OSS	One-Stop Shops
DP	Development Partners	PAF	Performance Assessment Framework
EITI	Extractive Industry Transparency Initiative	PARP	Poverty Reduction Action Plan
ESW	Economic and Sector Work	PEFA	Public Expenditure Framework Assessment
EU	European Union	PFM	Public Financial Management
FDI	Foreign Direct Investment	PI	PEFA Indicator
FARE	Economic Rehabilitation Fund	PIREP	Professional Skills Reform Program
FSAP	Financial Sector Assessment Program	PPP	Public Private Partnership
FSTAP	Financial Sector Technical Assistance Project	PRSL	Poverty Reduction Strategy Loan
G19	Budget Support Donor Group	PRSP	Poverty Reduction Strategy Program
GAP	Governance Action Plan	PSI	Policy Support Instrument
GBS	General Budget Support	RISP	Regional Integration Strategy Paper
GDP	Gross Domestic Product	ROSC	Report on the Observance of Standards and Codes
GoM	Government of Mozambique	SISTAFE	State Financial and Administrative System
GPSE	Growth and Public Sector Efficiency Program	SME	Small and Medium Enterprises
ICA	Investment Climate Assessment	TA	Administrative Tribunal
IGF	Inspectorate General of Finance	TVET	Technical Vocational Education and Training
IRM	Independent Review Mechanism	UA	Unit of Account
ISPPR	Institutional Support Project for Public Sector Reform		

## Loan Information

### Client's information

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**BORROWER:** Republic of Mozambique  
**EXECUTING AGENCY:** Ministry of Planning and Development

### Financing plan

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Source	Amount (UA)	Instrument
ADF	60 million	Loan
DfID	148 million	Grant
World Bank	127 million	Loan
Other G19 donors	464 million	Grant/loan
<b>TOTAL COST</b>	<b>799 million</b>	

### Timeframe - Main stepping stones (expected)

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Concept Note approval	May 2011
Program approval	September 2011
Effectiveness	November 2011
Completion	June 2013
Last repayment	June 2033

## Program Executive Summary

Program Overview	<p><b>Program Name:</b> Growth and Public Sector Efficiency Program (GPSE) P-MZ-K00-009</p> <p><b>Geographic Scope:</b> Mozambique national territory</p> <p><b>Overall Timeframe:</b> Three fiscal years: 2011– 2013</p> <p><b>Overall Loan Amount:</b> UA 60 million</p> <p><b>Program Description:</b> The goal of the program is to continue providing support to Mozambique’s ongoing agenda of structural reforms intended to stimulate broad-based economic growth and provide more opportunities for the country’s poor to benefit from growth. This entails: (i) deepening reforms initiated under the Bank’s Poverty Reduction Support Loan (PRSL) series that focused on improving the transparency and efficiency of public financial management, and (ii) undertaking further reforms to improve the environment for business creation and growth, especially among job-creating SMEs. The long-term inclusive growth strategy of the GoM is broadly supported by DPs, and the proposed GPSE program is closely coordinated with other multilateral and bilateral DPs operating in Mozambique.</p>
Program Outcomes and Beneficiaries	<p>Expected program outcomes include a more efficient and transparent use of public fiscal resources and a more conducive environment for job creation and skill acquisition, all with a view to promote more inclusive growth and accelerated poverty reduction. Program beneficiaries include the entire population, due to the broadness of the reform agenda. Specific beneficiary groups include: (i) SME owners and their employees due to smoother bureaucratic requirements for business and trade, greater access to credit and labor opportunities and a better-trained workforce; (ii) rural businesses and individuals due to expanded rural micro-lending, PPP-led transport and service infrastructure and local distribution of revenues from resource extractive industries; (iii) foreign and domestic investors due to a more reliable and transparent legal and regulatory framework; and (iv) taxpayers through strengthened PFM and greater revenue from mega-project concessions.</p>
Needs Assessment	<p>Mozambique is expected to face growing inflationary and fiscal pressures due to external factors such as international food and fuel prices and increased spending needs to address social concerns, which could threaten the country’s hard-won macroeconomic stability in the short term. The GoM is taking measures to maintain a prudent macroeconomic policy stance by reducing the overall spending envelope through austerity measures, including the gradual removal of the fuel subsidy, while at the same time strengthening the targeting of social protection programs. Since the consolidation of these efforts will be progressive, GPSE financing is instrumental to assist the GoM overcome these short-term fiscal needs. The GPSE loan will contribute to providing the GoM the fiscal space required to undertake these measures while continuing structural reforms and a stepped-up program of infrastructure investment needed to foster more inclusive economic growth.</p>
Risks and Risk Mitigation	<p>A sharp rise in the price of key food and fuel imports and/or an unexpected decline in donor aid flows could threaten macroeconomic stability and jeopardize reforms. This is mitigated by an IMF-supported macro policy framework as well as the budget support aid coordination framework agreed upon between G19 donors (including the Bank) and the GoM. Potential governance and social instability risks are mitigated by transparency and accountability mechanisms supported by this program, including EITI, audits and public procurement, as well as measures to increase income generation among the poor by promoting employment, skills development and better targeting of fiscal spending.</p>
Bank’s Added Value	<p>The Bank will bring to bear its cumulative experience in the region, such as expertise in skills training, microfinance and regional integration, and mutual trust with authorities built up through its involvement in Mozambique in the areas covered by the GPSE program. This operation will deepen the policy dialogue initiated during PRSL I and II and ongoing operations on the financial sector, business environment, the EITI transparency initiative and skills provision, and will be complemented by key technical assistance in coordination with other DPs. Further, the proposed operation will increase the predictability of donor financing (as it is designed over a time-frame of three fiscal years). It will also provide a catalytic impact—the Bank Group is strongly endorsing the PAF development policy framework and will bring the African perspective for improving its effectiveness.</p>
Institutional Development and Knowledge Building	<p>To enhance knowledge of Mozambique’s developmental challenges and priorities, the Bank will intensify policy dialogue at the country level through the GPSE. Lessons learned will inform the Bank Group’s advisory services to Mozambique as well as lead to a better design of Bank Group projects/programs going forward. The project team will document the lessons learned and disseminate the results Bank-wide through a variety of channels, to share learning on development best practices.</p>

## Results-Based Logical Framework

RESULTS CHAIN		PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/MITIGATION MEASURES
		Indicator (including Core Sector Indicators)	Baseline	Target		
IMPACT	Impact: Achieve sustained, inclusive economic growth based on increasing investments and contribute to poverty reduction	Poverty incidence	54.7% in 2008	50% in 2013	National Statistics Institute official data	<p><b>Risk 1 – Macroeconomic risk:</b></p> <ul style="list-style-type: none"> <li>- The GoM and/or the Central Bank could shift their currently solid policy stance to a more expansionary position, either through relaxed monetary policy or increased fiscal spending.</li> <li>- Increases in import prices of food and oil is likely to generate macroeconomic imbalances</li> <li>- Aid flows and FDI could decline sharply and unexpectedly.</li> </ul> <p><b>Mitigation measures:</b></p> <ul style="list-style-type: none"> <li>- The GoM has a sound macroeconomic policy framework supported by the IMF Policy Support Instrument (PSI). The GPSE program is supporting GoM financing needs and public sector spending efficiency.</li> <li>- The PAF framework increases the predictability of aid flows. The GPSE program includes measures to improve the overall investment climate, including FDI, to reduce dependence on aid flows.</li> </ul> <p>-----</p> <p><b>Risk 2 – Governance risk:</b></p> <ul style="list-style-type: none"> <li>- Inadequate control of corruption may impact the reform agenda, including the efforts to maximize the benefits from PPPs, mega-projects and regional trade.</li> </ul> <p><b>Mitigation measures:</b></p> <ul style="list-style-type: none"> <li>- The program supports transparency and accountability through several instruments (EITI, external audit, internal audit and public procurement).</li> </ul>
		Gross investment / gross private investment (% of GDP)	21% / 8% in 2010	23% / 10% in 2013		
OUTCOMES	Outcome 1: Enhance public sector efficiency and transparency	Deviation between budgeted and actual expenditure (in %)	5% in 2009	5% in 2012	MF and IMF data	
		PEFA indicator PI-19 on competition and procurement	B in 2010	B+ in 2013	PEFA final report	
		PEFA indicator PI-26 on scope, nature and follow-up on external audits	C+ in 2010	B in 2013	PEFA final report	
		EITI country compliance	Non-member	Compliant in 2013	EITI secretariat annual report	
		Outcome 2: Strengthen business creation, skill and technology acquisition	Time to start a business	13 days in 2010	9 days in 2012	
Number of people (women) trained in professional skills	43,500 (20,000) in 2010		100,000 (60,000) in 2013	Employment and Professional Training Institute data		
Trading across border: time to export and import	27 days in 2010		20 days in 2012	Doing Business		
	Cum. number of rural recipients (women) of microfinance credit	200,000 in 2009	300,000 (180,000) in 2013	Bank of Mozambique official statistics		
OUTPUTS	<b>Component I: Enhance Public Sector Efficiency and Transparency</b>					
	<i>I-A. Enhance the public finance management framework</i>					
	Expand the rollout of direct budget execution through e-SISTAFE	Percentage of the total value of budgetary spending using direct execution	37% in 2010	45% in 2011	MF, E-SISTAFE coordination committee data	
	Expand the coverage of the internal audit bodies	Percentage of organs with operational control units at central and provincial levels	75% in 2010	100% in 2011	Annual report on internal control, IGF	
	Expand the coverage of external audits of the state budget conducted by the TA	Percentage of the budget covered by external audits in accordance with norms	37% in 2010	40% by 2011	Court of Accounts annual report	

RESULTS CHAIN	PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/MITIGATION MEASURES
	Indicator (including Core Sector Indicators)	Baseline	Target		
<b><i>I-B. Make partnerships between the public and private sectors more inclusive and transparent</i></b>					
Submit the first EITI report	Submit the first EITI report to the international EITI secretariat	NA	The first report is submitted in 2012	EITI Mozambique secretariat annual report	<p>-----</p> <p><b>Risk 3 – Social risk:</b></p> <p>- Further social instability following the September 2010 riots remains a considerable risk. In addition to price increases, other triggers of political unrest could arise linked to the upcoming 2014 elections.</p> <p><b>Mitigation measures:</b></p> <p>- The program is supporting measures to increase revenue generation among the poor by promoting employment, skills development and better targeting of fiscal spending.</p> <p>-----</p>
Issue regulations covering public-private partnerships (PPP) and concessions	Cabinet approval of regulations	NA	The law approved by Cabinet by end-2011	Cabinet resolution	
Revise decree on procurement procedures to ease the requirements for small bidders and disseminate	Cabinet approval of the revised draft decree, dissemination plan implemented	NA	Cabinet approval by end-2011, dissemination plan completed by mid-2012	The revised decree and the presidential directive, MF resolution on dissemination	
<b>Component II: Improve the Environment for Business and Employment Creation</b>					
<b><i>II.A. Simplify business procedures and facilitate trade to promote job creation</i></b>					
Revise the decree relative to the one-stop shops for creating enterprises	Cabinet approval of the revised decree	NA	Revised decree adopted by 2012	Presidential directive	<p><b>Risk 4 – Institutional capacity constraints:</b></p> <p>- Inadequate fiduciary control systems, particularly at the district level, could delay reforms aimed at improving government fiscal capacity.</p> <p>- Limited institutional capacity is perceived to be a key constraint delaying implementation of reforms.</p> <p><b>Mitigation measures:</b></p> <p>-The Bank is supporting PFM systems both at the central and decentralized government levels</p> <p>-The Bank is also financing two institutional support projects (FSTAP, ISPPR) and ESW (PEFA update, including action plan).</p>
Operationalize an electronic single window customs management	Pilot phase of the electronic single window customs in at least two ports of entry by end-2011	NA	Pilot phase launched in 2012	Customs administration, MF directive	
Implement a first one-stop border shop on the Mozambique – South Africa border	The one-stop border shop is operational	Pilot phase	One-stop border shop operational in 2012	Customs administration, MF directive	
<b><i>II.B. Improve SME access to financial services and skilled human capital</i></b>					
Revise regulations on activities of microfinance institutions.	Approval of revised regulations by the Bank of Mozambique	NA	Regulations approved by December 2012	BoM directive	
Create the National Professional Education Authority (ANEP) for TVET	Approval of the decree for ANEP by Cabinet	NA	Decree for ANEP approved by Cabinet in 2013	Presidential directive	
Establish an Observatory and Labor Market Information System	Approval of the decree for the Observatory system by Cabinet	NA	Decree approved by Cabinet in 2013	Presidential directive	
<b>KEY ACT.</b>	<b>INPUTS</b>				
	ADF: UA 60 million (2011 - 2013). Other donors: UA 739 million, of which DFID UA 148 million, EC UA 128 million, WB UA 127 million and Norway UA 53 million UA.				

# **REPORT AND RECOMMENDATION OF THE MANAGEMENT TO THE BOARD OF DIRECTORS ON A PROPOSED LOAN TO MOZAMBIQUE FOR THE GROWTH AND PUBLIC SECTOR EFFICIENCY (GPSE) PROGRAM**

## **I. THE PROPOSAL**

1.1 **Management submits the following Report and Recommendation on a proposed loan to Mozambique for UA 60 million to finance the Growth and Public Sector Efficiency (GPSE) program.** It will be implemented over three fiscal years (2011-2013). The GPSE is the fifth general budget support operation for Mozambique, and it sustains and deepens reforms supported by the Bank's previous two Development Budget Support Loans (PRSL I and II). Its reforms are closely aligned to Mozambique's development objectives as set forth in the country's Poverty Reduction Action Plan 2011-2014. The program follows Paris Declaration principles in harmonizing with the interventions of other development partners, including the European Union, the World Bank, the International Monetary Fund and bilateral donors comprising the G19 aid group for Mozambique. The GPSE program was appraised in June 2011.

1.2 **The program's reforms are designed to assist Mozambique in broadening the social impacts of the country's robust economic growth on job creation, income generation and poverty reduction.** As such, the GPSE comprises two components. The first deepens the public sector governance reforms supported by the PRSL series to make government finances more transparent, efficient and effective, particularly in relation to public financial management, extractive resource concessions and public-private partnerships. The second focuses on key policy areas related to business, entrepreneurship and employment creation, such as smoothing the regulatory and legal framework for small and medium enterprises (SMEs), trade facilitation, credit expansion and professional skills training. The policy scope of the GPSE program is in line with a recent Bank evaluation of its policy based-operations 1999-2009. Expected program outcomes include a more efficient, sustainable and transparent use of public fiscal resources, a more conducive climate for entrepreneurs to take risks and to operate job-creating, value-added enterprises, and more opportunities for the poor to take part in and benefit from Mozambique's accelerating development.

1.3 **The policy areas and disbursement conditionality of this loan are embedded in the development framework agreed upon between the Government (GoM) and the G19 partners in the Memorandum of Understanding.** This policy framework explicitly links loan policies and disbursement conditions to an agreed matrix of indicators and targets, which are reviewed annually. The policy components of this operation as well as all prior actions and tranche disbursement conditions are linked to this framework. The program's conditions also take into account good practice principles on conditionality, and build on the design of the previous successful PRSL loan series.

## **II. COUNTRY AND PROGRAM CONTEXT**

### ***2.1 Government development strategy and medium-term reform priorities***

2.1.1 **Mozambique's vision focuses on generating economic growth by investing in infrastructure and leveraging the potential of agriculture and extractive industries, while simultaneously raising the standard of living through improved social services.** Mozambique's long-term goals are expressed in the Vision 2025, based on broad consultations with government, political parties, civil society and development partners (DPs). It gives priority to promoting rapid,

inclusive economic growth, especially in the rural areas, through investments in infrastructure and basic social services while creating an enabling environment for private sector development and job creation. A key aspect of the plan is to promote greater trade activity within southern Africa and to identify the country's comparative advantages in order to profit from its strategic positioning in the region.

**2.1.2 Mozambique has designed the Poverty Reduction Action Plan (PARP) 2011-2014 to operationalize the reform agenda.** The PARP builds on previous poverty reduction plans in its attention to greater government efficiency and transparency as well to accelerate social sector improvements. However, in reaction to a recent assessment showing that poverty reduction has weakened in Mozambique after 2003 despite rapid economic growth, the PARP 2011-2014 emphasizes measures to make growth more inclusive, in particular by facilitating small business activity and employment creation. This strategic adjustment benefited from input by representatives of government, civil society organizations, the private sector and DPs, including the Bank, in a high-level conference held near Maputo in February 2011.

**2.1.3. The PARP 2011-2014 sets the ambitious target of reducing poverty from 54.7% of the population in 2008 to 42% in 2014, in line with the Millennium Development Goal (MDG) of 50% in 2013.** To achieve this, the PARP envisions a series of reforms along three pillars: (i) increasing agricultural and fisheries production and productivity, (ii) promoting employment, and (iii) social and human development. These objectives are supported by the two cross-cutting pillars of sound macroeconomic management and improved governance. In the GoM's view, pro-poor growth can be achieved by focusing investments in agriculture and fisheries, which have very high growth potential in Mozambique, as well as by reducing existing obstacles to the creation and expansion of SMEs. The GoM seeks to promote linkages between SMEs and the burgeoning extractive industries and to leverage Mozambique's strategic geographic location as a hub for southern African commerce. In parallel, the GoM intends to redouble progress in social indicators—which have shown steady improvement since the mid-1990s—to achieve MDG targets.

**2.1.4 The reform agenda laid out in the PARP 2011-2014 is supported by all of Mozambique's DPs as a realistic and meaningful set of reforms that will move the country in the direction of more inclusive growth.** The G19 donors providing budget support considered Mozambique's agenda of social and economic reforms to be satisfactory, as highlighted in the May 2011 annual review. In its most recent review of Mozambique's Policy Support Instrument (PSI) program, also in May 2011, the International Monetary Fund (IMF) judged that overall reform program was on track and commended authorities for making good progress on structural reforms, although it highlighted potential future problems related to inflation and fiscal pressures.

## ***2.2 Recent economic-social developments, constraints and challenges***

**2.2.1 Since the end of the civil war in 1992, Mozambique has shown strong economic performance and continuing political stability.** Real growth rates averaged 8% per year from 1993 to 2009, with an estimated GDP increase of 6.6% in 2010. Since 2000, Mozambique has implemented market reforms and poverty reduction plans, which have been supported by both strong donor assistance and large-scale foreign direct investment (FDI) projects. As a result, Mozambique has been among the fastest growing economies of the region. The country has held successive peaceful elections, the most recent in October 2009.

**2.2.2 Robust economic growth led to significant strides in poverty reduction up to 2003, but progress has since slowed.** Household survey data show a decrease in poverty from 69% to 54.7% between 1996 and 2008. However, results from the 2008/2009 Household Survey indicate that

poverty has stagnated at 54%, due to the slow growth in agriculture productivity, adverse weather shocks affecting the 2008 harvest, declining terms of trade and the capital-intensive character of major resource extraction projects. The situation appears slightly better in urban areas, with poverty continuing to decline to 50%, while rural poverty rose since 2003 to 57%. Over this period, Mozambique made substantial progress in numerous indicators of social wellbeing, including many of the MDGs (Annex 4). This progress has continued steadily since the 1990s, despite the slowing poverty reduction, suggesting that public social policies are having a positive impact. Nonetheless, Mozambique had a Human Development Index composite score of 0.28 in 2010, one of the lowest in the world and well below the sub-Saharan Africa average of 0.39.

**2.2.3 The prompt GoM response to the global economic downturn enabled Mozambique to sustain its good economic performance.** During 2009, export earnings fell (particularly in the aluminum sector), and capital inflows and donor financial aid declined. In response the GoM eased macroeconomic policies and contained the spillover effects to the domestic economy. Despite the counter-cyclical fiscal policy, fiscal performance remained strong, with tax revenue collections increasing from 14% of GDP in 2005 to 16% in 2010. After a downturn in 2009 due to counter-cyclical policies to deal with the global crisis, the fiscal deficit recovered in 2010 on the basis of spending restraint (Table 1).

**Table 1: Key Macroeconomic Trends**

	2008	2009	2010e	2011e
Real GDP Growth (%)	6.8	6.3	6.6	7.2
Inflation (average, in %)	10.3	3.3	12.7	9.5
Overall Fiscal Balance (aft. grants, % of GDP)	-2.5	-5.4	-3.7	-6.4
External Current Acc. Balance (% of GDP)	-12.2	-12.1	-10.2	-11.4
Gross Domestic Investment (% of GDP)	18.5	16.3	20.6	21.6
FDI (in millions US\$)	587	890	790	867

Note: e= estimate; Source: Ministry of Finance and IMF data.

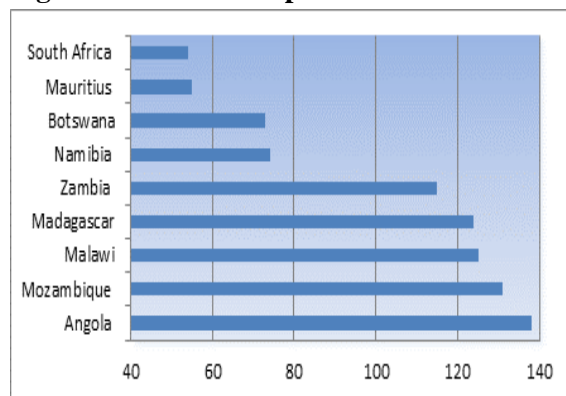
**2.2.4 Increased cost of living led the GoM to freeze prices of essential basic goods and services in September 2010.** A bread subsidy was introduced, tariff increases for electricity and water for poor households were cancelled and subsidies for urban transportation were maintained. Nonetheless, inflation stood at around 13% in 2010, reflecting the sustained impact of food and fuel price increases and the depreciation of the local currency. The IMF's most recent PSI review pointed to inflation as a key challenge, and recommended that authorities maintain prudent monetary and fiscal policies to keep price growth in the single digits moving forward (Annex 5). The IMF further noted that while authorities had exercised generally restrained fiscal policy in recent years, fiscal pressures would likely increase in 2011 and 2012, in particular due to the rising cost of fuel subsidies.

**2.2.5 Mozambique's medium-term structural development challenges remain enormous.** Real gross national income per capita stands only at US\$380 (AfDB, 2008). More than half of the population lives below the poverty line, and three out of four Mozambicans live on less than US\$1.25 a day. The economy remains highly dependent on aid flows (46% of budgetary resources) and vulnerable to external shocks, notably oil and food import prices and climatic disasters. The economic structure remains narrow and based on agriculture, which employs about 80% of the active population and represents 25% of GDP (2009), followed by manufacturing at 15% (mostly the Mozal aluminum smelter). The export base is also very narrow, with aluminum comprising more than half of Mozambique's exports and only 15 products registering annual exports higher than US\$1 million in 2010.

**2.2.6 Pervasive constraints to private sector investment, operations and trade remain, especially for SMEs.** Mozambique ranks 131 out of 139 countries in the 2010 Global Competitiveness Index and 126 out of 183 countries in 2011 in the Ease of Doing Business Index

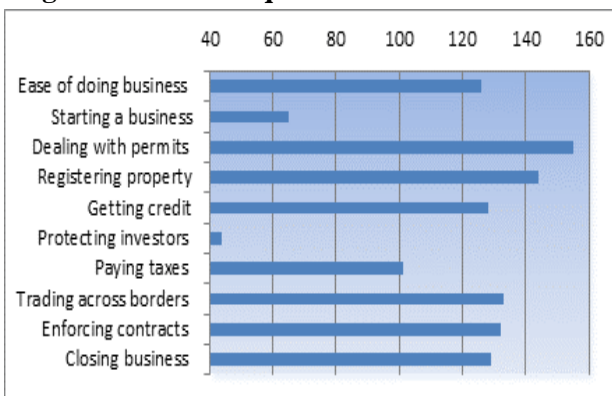
(Figures 1 and 2). Lack of efficiency and transparency of the justice system, corruption and conflict of interest remain central issues to be addressed. Mozambique ranks 116<sup>th</sup> out of 178 countries in the 2010 Transparency International Corruption Perceptions Index. Inadequacy of skills is a major obstacle for business development. About one-third of the labor force has only primary education and about 300,000 young workers enter the labor market annually, mostly being absorbed by the informal sector (2003 data).

**Figure 1: Global Competitiveness Index 2010**



Note: Lower ranking indicates better performance  
Source: 2010 Global Competitiveness Report

**Figure 2: Mozambique DB Indicators 2011**



Note: Lower ranking indicates better performance  
Source: Doing Business Report

**2.2.7 Public sector reform, and in particular public financial management (PFM), is a key reform area to improve the GoM's ability to address development needs and reduce poverty more quickly.** Corruption and poor management of public resources is a major concern for the efficient use of scarce public funds to promote economic growth, although reforms in public financial management are slowly improving the situation. The GoM has satisfactorily completed three consecutive public expenditure and financial accountability (PEFA) assessments, the most recent in December 2010 (see Technical Annex 4), and is advancing steadily in the implementation of internal and external audits and integrated financial management systems. Because of the critical cross-cutting nature of public sector management for Mozambique's development prospects, this is a key area of support in this operation, as detailed in Section 4 below.

### **2.3 Bank Group portfolio status**

**2.3.1 As of June 30, 2011, the Bank's portfolio in Mozambique consisted of 16 approved and ongoing operations with a total commitment value, net of cancellations, of UA 333 million.** Of this total, 62% of Bank resources were dedicated to public sector operations, another 31% to regional operations and 7% to private sector operations. Infrastructure (power, roads, water) represents 70% of the approved and ongoing portfolio. The disbursement ratio for ongoing operations was 18% at end-2010, close to the Bank-wide average of 17%. The average project age since approval is 4.9 years, as compared to the Bank-wide average of 4.3 years.

**2.3.2 The main factors affecting portfolio performance are delays in loan effectiveness and first disbursement and low project management capacity of implementing agencies.** A plan has been put in place to improve portfolio quality through a set of measures that include permanent interaction with the project implementing agencies, streamlined design for new operations (especially in terms of conditionality) and canceling ageing operations.

### III. RATIONALE, KEY DESIGN ELEMENTS AND SUSTAINABILITY

#### 3.1 *Link with the CSP, country readiness assessment and analytical underpinnings*

3.1.1 *Link with the CSP:* The program dovetails with the Bank’s results-based Country Strategy Paper 2011-2014 and the Medium-Term Strategy 2008-12 by focusing on strengthening public sector governance and creating an enabling environment for private sector growth, job creation and skills development (Table 2). The infrastructure pillar of the CSP is also supported through the GPSE, which addresses the creation and implementation of a legal framework for public-private partnerships (PPPs) and opens procurement opportunities to SMEs. Furthermore, the operation is aligned with the Southern Africa Regional Integration Strategy (RISP 2011-2015),<sup>1</sup> particularly the component focusing on trade facilitation and the pilot one-stop shop border crossing with South Africa. The GPSE is also aligned with the Bank Governance Strategic Directions and Action Plan (GAP 2008-2012) by strengthening country systems for managing public resources with an emphasis on oversight institutions and accountability systems. The loan design builds on wide-ranging consultations undertaken with civil society and the private sector during CSP preparation.

**Table 2: Links between CSP and GPSE Operation**

CSP 2011-2014 Pillars	GPSE 2011-2013 Components
<b>Pillar 1:</b> Infrastructure Development Promoting Social Inclusion and Economic Competitiveness	<b>Improve the Environment for Business and Employment Creation</b> <ul style="list-style-type: none"> <li>• Access to credit for SMEs</li> <li>• Promote microfinance in rural areas</li> <li>• National training authority for TVET</li> <li>• Simplification of procedures to start a business</li> <li>• Regional trade facilitation: single window for customs and one-stop border shop</li> </ul>
<b>Pillar 2:</b> Governance in Support of Inclusive Growth	
	<b>Public Sector Efficiency and Transparency</b> <ul style="list-style-type: none"> <li>• PFM: budget execution, internal and external audit</li> <li>• Public spending: procurement and PPPs</li> <li>• EITI</li> </ul>

3.1.2 *Country readiness assessment:* Mozambique fulfills the general and technical prerequisite conditions for general budget support. The two general and the six technical prerequisite conditions for budget support operation are fulfilled, as detailed in Table 3 below.

**Table 3: Summary Assessment of Program Prerequisite Conditions**

Prerequisite conditions	Focus	Comments on current situation
<i>General prerequisite</i>	Political stability	Following the end of civil war, the last decade was characterized by a strong political commitment to foster economic and social growth. The incumbent president was reelected in October 2009 with 75% of the vote and the ruling party obtained a large majority. The new government is committed to address the lack of inclusiveness in the democratic process and to strengthen the role of opposition parties in Parliament. The political outlook is stable and positive.
	Economic stability and GoM’s commitment	Mozambique’s economic performance for the past decade has been very strong and the GoM has been implementing a broad program of structural reforms. Supported by these reforms, the economy grew by 8% annually on average between 1993 and 2009.

<sup>1</sup> The Southern Africa RISP (2011-2015) has two main pillars: (i) regional infrastructure: regional transport/trade facilitation infrastructure, regional energy development and information and communications technology; and (ii) capacity building: support the CES tripartite arrangement, institutional strengthening, trade and transport facilitation and aid for trade.

		There is strong momentum for continuing the reform program and achieving even higher growth rates. The reform implementation track record is strong, as noted both in the joint annual donor review and the IMF Article IV review in May 2011.
<i>Technical prerequisite</i>	Existence of well-designed PRSP and effective implementation mechanisms	The PARP series includes a strategic matrix of key indicators, and represents a joint effort by the GoM, donors and civil society. The PARP II, approved in May 2011, focuses on increasing agricultural productivity, stimulating employment generation and promoting human and social development. Monitoring indicators are submitted annually to Parliament and monitoring is open to participation from the public and representatives of CSOs through the development observatories.
	Viable medium-term macroeconomic and financial framework	The medium-term macroeconomic outlook is positive. Real GDP growth is expected to reach 7% in 2011. Sizeable FDI flows are expected in the next years for new mining projects. The second IMF PSI review concluded that the prospects for 2011-2012 are favorable, including continuous growth and a sustainable external and fiscal situation. The IMF concurs that the authorities are committed to macroeconomic stability and fiscal sustainability, and that the current macro-policy framework is satisfactory for continuing with budget support.
	Strong partnership between RMC and donors	An MoU was signed in 2009 between the GoM and 19 donors (including the Bank) for providing general budget support. The coordination framework includes a series of “fundamental principles”, including: predictability and alignment with domestic systems; joint monitoring of program measures through the Performance Assessment Framework (PAF); and common reporting to donors and mutual accountability.
	Strong donor partnership	Donors are collaborating to simplify budget support coordination and to enhance the quality of the joint PAF. See Section 3.2 below for more information.
	Satisfactory fiduciary review of the public financial management system (use of country system)	Several satisfactory fiduciary risk reviews have been undertaken in Mozambique, including a 2010 PEFA, a 2007 Report on the Observance of Standard Codes (ROSC) and a 2008 Country Procurement Assessment Review (CPAR). The G19 PFM Quality Assurance Group mission in March 2009 and the 2009 IMF mission on progress with PFM reforms concluded that the PFM system is adequate for budget support operations. The IMF 2008 safeguards assessment confirmed that the Bank of Mozambique’s control, auditing, reporting and accounting systems are aligned with international standards. Financial management and procurement assessments conducted in June 2011 by Bank experts (Technical Annexes 7 and 8) confirmed that PFM systems are adequate for GBS operations.

3.1.3 *Analytical work and underpinnings:* **The design of the budget support operation was guided by various analytical works.** Dialogue during the Bank’s 2011-2014 CSP preparation with the GoM, country-level stakeholders and other DPs identified policy priorities to address the current challenges. Key findings and recommendations of the 2010 PEFA were considered in program design (see Technical Annex 4). The operation also benefited from the assessment of governance challenges using recent and ongoing analytical work evaluating the previous PARP 2006-2010, PFM Vision 2010-20 and the Project Completion Report of the Bank’s PRSL II, 2008-2010. The design of the operation’s business environment component benefitted from the World Bank’s Investment Climate Assessment in Mozambique, Doing Business 2011, the Global Competitiveness Report 2010-2011, a USAID study on informality (2009), the National Poverty Assessment (2010) and an EDRE/OSHD paper on youth employment in Africa (2011). The World Bank-IMF Financial Sector Assessment Program (FSAP) as well as studies on the financial sector elaborated through the Bank-financed Financial Sector Technical Assistance Project (FSTAP) contributed to the design of the program, particularly in the area of strengthening access to financial services. In addition, the findings of the joint reviews 2008-2011 between the GoM and G19 donors helped to shape the operation.

### 3.2 Collaboration and coordination with other donors

3.2.1 **The Memorandum of Understanding (MoU)<sup>2</sup> signed in March 2009 between the GoM and G19, including the Bank, constituted a breakthrough in donor harmonization in Mozambique.** It is based on a set of ‘fundamental principles’: (i) predictability and alignment with domestic systems; (ii) joint monitoring and all policy actions or expected outcomes are based on the common PAF; (iii) no separate reporting to the donors; and (iv) mutual accountability. The PAF is elaborated annually and reviewed in the following year jointly by the GoM and donors. The Bank has closely followed the principles laid out in the MoU and the policy framework detailed in the PAF in the design of this operation. This includes basing all prior actions and disbursement conditions explicitly on the PAF framework, as agreed in the MoU. As well, policy measures envisaged in the proposed operation have been discussed with other DPs involved in these areas in Mozambique to maximize complementarities and maintain coherence with the GoM’s reform agenda.

3.2.2 **The Bank has a good track record of collaboration in Mozambique through support to public sector reforms and PFM issues.** The Bank has undertaken joint missions for institutional financial sector reforms with the World Bank, GTZ and KfW within the context of the FSTAP. The Bank, Norway and Switzerland co-financed the 2010 PEFA report. In addition, the Bank, the World Bank and DfID are jointly supporting transparency and accountability reforms as part of the Extractive Industries Transparency Initiative (EITI). The coordination of intervention is also organized through respective thematic working groups. The Bank is actively involved in the roads, economic issues, education, poverty analysis, private sector, PFM and governance working groups.

### 3.3 Outcomes of past and ongoing similar operations and lessons

3.3.1 **The proposed operation is the fifth Bank GBS operation for Mozambique.** Its design benefitted from the experiences of the ongoing institutional support projects and the lessons from the evaluation of the previous operations, including the PRSL II, 2008-2010. Further, the operation follows the lessons drawn from the Country Portfolio Improvement Plan (CPIP) 2011. Since 2000 the Bank has approved four GBS operations for a total disbursed amount of UA 200 million. Some of the key lessons learned and related actions taken for this proposed operation are detailed in Table 4 below.

**Table 4: Lessons Learned from Past Policy-Based Operations**

Lessons from previous PBOs	Action taken to integrate lessons on the program
<i>Government ownership and close coordination with DPs are critical for effective implementation</i>	The proposed program selects areas of intervention with strong GoM ownership and champions identified leading specific reforms. The inclusion of reforms to facilitate inclusive economic growth specifically responds to the GoM’s new policy thrust, as articulated in the PARP 2011-2014. It is designed in close collaboration with the field office staff in charge of donor coordination.
<i>Indicators should be drawn from the PAF strategic matrix</i>	GPSE outcome indicators are based on the PAF, which continues to be drawn from the new PARP (2011-2014).
<i>Streamline monitoring mechanisms</i>	Leaders of G19 donor working groups were consulted during the preparation of the GPSE. The Bank is participating actively in the G19 working groups in charge of monitoring the PAF matrix.
<i>Ensure complementarities with other Bank-financed operations</i>	The choice of program focus and benchmarks is supported by ongoing and future institutional support projects and ESW, notably the ISPSS project on business creation and projects to facilitate regional trade integration.

<sup>2</sup>All information on the coordination is publicly accessible on the Program Aid Partners website: <http://www.pap.org.mz/>

<i>Increase selectivity and reduce the number of disbursement conditions</i>	Two prior actions from the PAF linked to the policy program were selected for operation approval. Overall satisfactory approval of subsequent PAFs and two key policy reforms are the only conditions for 2012 and 2013 disbursements.
<i>Increase aid predictability by ensuring financing over the medium term</i>	This is a multi-year program supporting three fiscal years with tranche timings suited to GoM needs and expectations, as confirmed during appraisal.

### **3.4 Relationship to ongoing Bank operations and sustainability**

**3.4.1 The proposed operation has strong linkages with Bank activities in Mozambique, both currently and moving forward.** Improving public sector efficiency will enhance project management capacity for other Bank-financed projects. This will benefit upcoming Bank Group lending projects as defined in the new CSP, in particular ongoing and planned infrastructure investments in the transport and water sectors.<sup>3</sup> These projects will also benefit from operation activities related to clarifying the legal framework for PPPs. The Nacala Multinational Road Corridor project will complement policy reforms supported by the GPSE to further promote trade. Activities related to auditing public accounts will strengthen confidence in the GoM’s transparent use of Bank resources for all projects. Reforms related to increasing access to credit link up with the ongoing FSTAP and the Rural Finance Intermediation Support Project. The work of the Women Entrepreneurship Skills Development Project is aligned with policy actions on the development of professional skills and promotion of SME activities, while the Institutional Support Project for Public Sector Reform (ISPPR) is providing technical assistance to implement the single window for opening a business.

**3.4.2 Program sustainability is strengthened by the choice of policies supported, the operation’s tranching design, and the overall donor coordination framework.** The most important aspect supporting program sustainability is that the operation focuses support on the areas that the GoM itself has selected as critical to its own development agenda for the next four years, as defined in the PARP II. The judicious use of conditionality also supports sustainability, by selecting two key areas to serve as prior actions—thus demonstrating the GoM’s commitment—and basing two future disbursements on continued progress with the overall reform agenda and two policy reform actions critical to the goals of the GPSE program (see Section 6.2). Lastly, the PAF donor framework ensures that donors and the GoM closely monitor actions in the medium term to sustain momentum moving forward.

### **3.5 Bank’s comparative advantages**

**3.5.1 The Bank has several comparative advantages in the GPSE budget support operation.** The Bank is directly involved in PFM and private sector development reforms, including several policy areas ongoing from the PRSL loans. The Bank is playing a key role in elaborating the PEFA assessment and the EITI report, financing one-stop shops for creating firms and supporting the access to credit strategy, in conjunction with KfW and the World Bank. The Bank has strong regional experience in technical vocational education and training (TVET) and SME promotion, which will enhance the effectiveness of the skill promotion and inclusive growth agenda. The Bank has financed a number of TVET and SME development initiatives in Botswana, Congo Brazzaville, Ghana, Kenya, Mozambique, Rwanda, Sierra Leone and Uganda, among other countries. It is currently preparing similar operations in Eritrea, Ghana, Malawi and Tanzania. The Bank is

<sup>3</sup> The effort to increase synergies between the proposed operation and other Bank interventions in Mozambique is line with the recommendation of the recent evaluation report on Policy-Based Operations of the AfDB 1999-2009, ADF/BD/WP/2011/34.

conducting an assessment on technical training and skills development in Africa, which will further strengthen its knowledge base in this area. In terms of operation modality, the Bank is one of the few G19 donors able to provide financing over three fiscal exercises, which will increase the predictability of donor financing. The Bank also provides a unique African perspective for improving donor effectiveness highly valued by GoM counterparts.

### 3.6 *Application of good practice principles on conditionality*

3.6.1 **The program will apply good practice principles on conditionality (Box 1).** The Bank is working closely with other DPs providing budget support and the IMF within the PAF framework, to ensure better coordination and increase synergy.

#### **Box 1: Application of Good Practice Principles on Conditionality**

**Principle 1: Reinforce ownership.** The proposed operation supports the GoM's governance and economic revitalization goal that is a core element of the PARP 2011-2014, endorsed by DPs in May 2011. The GPSE specifically addresses the GoM's priority aims of continuing PFM reforms and undertaking new reforms to spur job creation and pro-poor growth. The GoM has a strong track record of ownership and commitment to reform through the successful implementation of past reforms, including those in the PRSL operations.

**Principle 2: Agree up front with the government and other development partners on a coordinated accountability framework.** The GoM and donors have agreed on a coordinated accountability framework for the joint monitoring of PARP activities undertaken annually, the most recent being a satisfactory review in May 2011. Donor aid coordination and policy dialogue have improved with the establishment of a joint performance assessment under the MoU signed in March 2009.

**Principle 3: Customize the accountability framework and modalities of Bank support to country circumstances.** The proposed operation responds to the GoM's request for more aid to be channeled through the budget, along a tranching disbursement schedule suitable to their needs and targeted at PARP priorities.

**Principle 4: Choose only actions critical for achieving results as conditions for disbursement.** Loan approval will be subject to two prior actions, both drawn from the PAF performance matrix agreed between the G19 donors and GoM as stipulated by the MoU. The focus of these prior actions is on improved transparency in use of public funds. For the second and third tranches, the condition will be the overall satisfactory performance of the PAF matrix in the annual joint review process as well as two policy reforms critical to the overall goals of the GPSE program (related to EITI and new business creation). This structure of prior actions and tranche disbursement conditions follows the successful example of the PRSL II loan operation.

**Principle 5: Conduct transparent progress reviews conducive to predictable and performance-based financial support.** A steering committee chaired by the Minister of Finance is responsible for the oversight of PFM reform, including the measures supported by the budget support program. The committee receives and reviews progress reports from the Reform Coordination Unit. In addition, disbursement of the budget support program is subject to satisfactory completion of the benchmarks. Mozambique is one of the few countries to have satisfactorily completed three consecutive PEFA assessments. The recommendations for the latest assessment in 2010 will form part of the action plan to strengthen PFM systems in Mozambique.

## IV. THE PROPOSED PROGRAM AND EXPECTED RESULTS

### 4.1 *Program's goal and purpose*

4.1.1 **The development objective of the proposed operation is to create the conditions to foster more inclusive economic growth and poverty reduction by enhancing public sector efficiency, skilled human capital development and job creation.** The GPSE aims at consolidating and deepening the public sector governance reforms launched with the support of the previous two PRSL operations, and supporting the new reform priorities of the GoM to promote pro-poor economic growth to accelerate poverty reduction and improvements in wellbeing (Box 2).

## Box 2: Purpose of GPSE

**To enhance public sector efficiency and effectiveness promoting inclusive growth by supporting sector strategies on public financial management and public investment, to:**

- Maintain the deviation between budgeted and actual expenditure at a maximum of 5% in 2012.
- Improve PEFA indicator PI-19 on competition and procurement from B in 2010 to B+ in 2013.
- Improve PEFA indicator PI-26 on external audits from C+ in 2010 to B in 2013.
- Mozambique accepted into EITI membership and compliance by 2013.

**To strengthen business and employment creation, particularly for SMEs, by supporting reforms on business and trade regulation, access to credit and professional training, to:**

- Reduce the time needed to start a business from 13 days in 2010 to 9 days in 2012.
- Streamline the time needed for cross-border trade from 27 days in 2010 to 20 days in 2012.
- Increase the number of people trained in professional skills from 43,500 in 2010 to 100,000 in 2013.
- Increase the cumulative number of rural recipients of microfinance credit from 200,000 in 2009 to 300,000 (of which 180,000 are women) in 2013.

## 4.2 Program's components, operational policy objectives and expected results

4.2.1 **Consistent with the GoM policy agenda and lessons learned from past operations, the proposed GPSE operation is structured in two components:** (i) enhancing public sector efficiency and transparency; and (ii) improving the environment for business creation, entrepreneurship and employment growth. The operation will support creating the conditions for sustainable, inclusive economic growth and poverty reduction by enhancing public sector efficiency, accountability and transparency, facilitating business creation and trade opportunities, and promoting access to financial services, skills and technology for SMEs. A particular focus is to improve the public resource framework and business-enabling environment to leverage the high potential of natural resource exploitation and the country's strategic regional location.

4.2.2 **The selection of program components strikes a balance between key reforms to achieve intended impacts, the capacity of government agencies and complementary reforms supported by other DPs.** The policy areas addressed in this operation are a sub-set of the GoM's broader development agenda, as laid out in the PARP 2011-2014. Policies related to public finances were chosen to provide continuity with the policy trajectory supported by the previous PRSL loans, while policies on effectiveness of public spending and the overall business environment respond to the clearly stated aim of the GoM to build on its impressive recent macroeconomic performance to make growth more inclusive. Other DPs are focused on different aspects of the PARP reform agenda (see Technical Annex 2).

### **Component I: Enhance Public Sector Efficiency and Effectiveness in Promoting Inclusive Growth**

4.2.3 **This component combines a focus on policy areas addressed in the previous PRSL loan series with new policies designed in line with the GoM's goal of promoting pro-poor growth.** As such, it is divided into two sub-components: (i) enhance the PFM framework, and (ii) make partnerships between the public and private sector more inclusive and transparent. The first sub-component is designed to consolidate and deepen reforms which have been ongoing for several years and supported by the PRSL loans, while the second is oriented toward opening public procurement to SMEs and addressing challenges posed by the increasing importance of large-scale private resource extraction projects and planned public-private infrastructure investments. Both are geared toward the final aim of maximizing the impact of Mozambique's fiscal and natural resources on inclusive growth and poverty reduction.

### ***Sub-component Ia: Enhance the Public Financial Management Framework***

**4.2.4 *Recent Achievements:* Mozambique has made considerable progress on PFM reforms in recent years, effectively supported by the Bank's PRSL loan series.** The past three PEFA assessments of the country's fiscal systems, including the most recent one completed in December 2010, were all satisfactory (see Technical Annex 4). The 2010 PEFA highlighted progress in the orderliness of the overall budget process, transparency of taxpayer obligations and internal expenditure controls. The rollout of the electronic state financial management system (e-SISTAFE) has advanced steadily since the initial pilot in 2005. Growing use of e-SISTAFE has helped reduce the deviation of planned from actual budgetary execution to less than 5% by 2010. The use of both internal and external audits has expanded significantly, with the Administrative Tribunal (TA) taking on an increasing number of audits each year (from 69 in 2005 to 451 in 2009) and opening provincial branches as part of the GoM's decentralization drive.

**4.2.5 *Current Challenges:* In light of solid progress shown in recent years, the main challenges regarding PFM are to sustain reform momentum moving forward.** Overall, the GoM aims to improve its PEFA ranking by continuing and deepening the recent reforms described above. This involves implementing the e-SISTAFE system in more public units and covering a greater share of public spending in the annual budget cycle. Internal and external audits need to become an increasingly embedded element of the normal budgetary cycle, with the results informing future budgetary decisions. Currently the recommendations of both external and internal audits are not followed up. As well, the backlog of completed Administrative Tribunal's (TA) audits awaiting adjudication is large and growing. Integration of these two aspects of PFM is weak, since auditors rely on paper receipts for their work and do not accept e-SISTAFE reports.

**4.2.6 *Reform Agenda Going Forward:* The GoM's main focus between now and 2013 is to consolidate and deepen ongoing reforms in PFM, a strategy fully supported by this GPSE operation and other donors.** Regarding control of budgetary expenditure, the Ministry of Finance (MF) intends to continue e-SISTAFE rollout to cover 45% of all spending through direct budget execution and a total of 50 institutions by end-2011. The plan is to complete the rollout to all public entities, including autonomous institutions, by 2014. As well, an IT master plan to coordinate e-SISTAFE and other PFM components is to be adopted by the end of August 2011. Regarding oversight, audit coverage will continue to expand with the aim of achieving 40% of budget covered by TA external audits and implementing internal operational control units in 100% of organs at the central and provincial level with operational control units, both by the end of 2011. In 2012 and 2013, the GoM intends to strengthen follow up to both internal and external audits, and also to integrate e-SISTAFE into the internal auditing process by training auditors on the use of the system. The proposed operation will support the continued rollout of e-SISTAFE as well as the expansion of internal and external audits.

### ***Sub-component Ib: Make partnerships between the public and private sectors more inclusive and transparent***

**4.2.7 *Recent Achievements:* Improving the framework for public-private partnerships and resource extraction concessions is a new policy focus, while some progress has occurred in procurement.** A new law governing the modalities of public-private partnerships (PPPs) and concessions was passed in May 2011, designed with considerable input from numerous DPs including the Bank. The legal, regulatory and tax frameworks for resource projects were overhauled in 2007 to provide transparent, uniform criteria for all investors and to increase the previously limited contribution of projects to government revenue. Mozambique was admitted as a candidate

country to the Extractive Industries Transparency Initiative (EITI)<sup>4</sup> in May 2009, established a secretariat in 2010 with the help of the Multi-Donor Trust Fund and the Bank, and has initiated the first report on resource extraction company activities. The first stage of procurement reforms, begun in the mid-2000s, focused on establishing a centralized procurement institution (UFSA), implementing a transparent legal and regulatory framework and increasing the use of competitive bidding.

**4.2.8 *Current Challenges:* It is essential for Mozambique to rapidly finalize the legal and institutional framework in advance of upcoming PPPs and mega-projects, and efforts are needed to open procurement opportunities for SMEs.** Recently-passed legislation on PPPs and concessions creates a solid framework, but requires regulations to be put into action. As well, the newly-created PPP office in the MF remains a work in progress, with significant training needs. While the launch of the EITI secretariat is a strong positive step, the report process is just beginning, and will require further fine-tuning after the first validation report has been submitted to the EITI International Board and assessed. Particular areas of concern relate to the involvement of civil society and coordination between the MF and the Ministry of Mining Resources, which should be addressed as the process moves forward. This process is critical to help Mozambique avoid the “resource curse” dangers inherent in sudden resource income and spending. While current procurement legislation is relatively good, complex rules and requirements limit the ability of SMEs to participate, in turn reducing the ability of public sector transactions to spur inclusive growth.

**4.2.9 *Reform Agenda Going Forward:* The GoM plans to push ahead with the policy agenda described above with a view to maximizing the benefits derived from extractive industry projects and PPP investments.** Regulations for the new PPP and concession law are currently being drawn up and will be approved before the end of 2011, including a stipulation that 5-20% of each concession be made available to local investors. The new MF PPP office will continue adding technical staff in the coming year, and expects to approve the first PPPs in 2012. Regarding EITI, Mozambique will submit a revised 2009 reconciliation report to the EITI Secretariat for validation by December 2011 and achieve full membership by 2012. It also plans to finish work on the first report of mining and hydrocarbon concessions and initiate two more studies by end-2012 and end-2013. A 2011-2013 EITI Action Plan will be completed by the GoM (*GPSE Disbursement Condition*). The Cabinet is expected to take up reforms to procurement regulations before the end of 2011 intended to encourage the participation of SMEs by simplifying procedures for certain types and amounts of government purchases, followed by an intensive dissemination plan to promote these new business opportunities. The proposed operation will support the completion and dissemination of the new PPP/concession regulations, the completion of the first EITI report and the revision of the procurement decree to promote SME involvement.

## **Component II: Improve the Environment for Business and Employment Creation**

**4.2.10 The second component focuses on policies that reduce legal and regulatory obstacles and increase access to key inputs, with the aim of promoting greater economic activity, especially among job-creating SMEs.** To achieve these aims, the component focuses on two policy areas: (i) simplify business and cross-border procedures, and (ii) improve the supply of financial services and skilled human capital. According to the Global Competitiveness Report 2010-2011, lack of skilled workers, limited access to credit and inefficient government bureaucracy are among the most problematic factors for private businesses in Mozambique, a finding echoed in Doing Business

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<sup>4</sup> The EITI is an international initiative to improve transparency in the relations between resource extraction companies and host countries, with the aim of improving the use of revenues for the benefit of development and to avoid the “resource curse.” For more information, see [www.eiti.org](http://www.eiti.org).

2011 and the World Bank's 2010 Investment Climate Assessment. These constraints are especially binding on SMEs, which are the most labor-intensive and tend to have the greatest impact on poverty. Hence, the GPSE targets these three areas to maximize the impact of policy changes on promoting inclusive growth. The policy areas supported in this component were discussed not only with the GoM and other donors, but also Mozambique private sector representatives in the Confederation of Economic Associations.

***Sub-component IIa: Simplify business procedures and facilitate trade to promote job creation***

**4.2.11 *Recent Achievements:* Mozambique has made significant progress easing the ability of a business to begin operations, and has begun efforts to streamline border and customs procedures to facilitate international trade.** The time required to open a business in Mozambique has dropped remarkably in recent years, from 153 days in 2004 to 13 days today according to Doing Business data, and the associated costs have dropped considerably as well. The One-Stop Shop (OSS) to open a business was approved by decree 14/2007 and implementation has begun. Efforts to reduce customs procedures for exports and imports have begun as well, though with limited progress thus far. In 2009 the GoM began simplifying customs procedures and putting them on an online portal, in partnership with the private sector. A prototype of the new portal was presented in May 2010 and has since been undergoing testing and adjustments, with a view to begin implementation in late 2011. The GoM has put into action a strategy of modernizing border crossings. In 2010 the pilot phase began at the Ressano-Garcia Lebombo crossing to South Africa, Mozambique's busiest crossing, with the aim of creating a one-stop crossing such that all required procedures for both countries are done in a single facility.

**4.2.12 *Current Challenges:* Further efforts to simplify bureaucratic red tape for opening a business and for international trade are critical if Mozambique is to achieve its goal of broadening the impact of economic growth on poverty.** While the existing large companies have the clout to cope with or bypass bureaucratic obstacles, SMEs and individual entrepreneurs face a much more difficult task. The number of procedures and time required to open a business is still onerous for a small business owner, and existing simplification efforts have not expanded to many parts of the country. In particular OSS coverage in rural areas is limited. While improvements to customs and border crossings are appear well-designed, the challenge now is to move from the planning stage to actual implementation, to have a real impact on the ability of Mozambique businesses to engage in international commerce and to turn proposed trade transit corridors into a reality.

**4.2.13 *Reform Agenda Going Forward:* The GoM has a policy agenda focused on deepening business procedure simplification, implementing the online portal for customs and initiating more one-stop border posts.** The Commerce Ministry is currently undertaking an inventory of business opening procedures, and intends to submit more procedures to incorporate into the OSS to the Council of Ministers by September 2011, with approval expected by the end of the year. OSS offices are continuing to be built, with four to be completed by the end of 2011 and another four in 2012, all outside the capital (*GPSE Disbursement Condition*). The online customs portal will begin operations in 2011 with a pilot phase in Maputo, Beira and Nacala covering a sub-set of procedures. The full rollout—covering all ports of entry and all procedures—is expected by 2013. The final infrastructure at the pilot one-stop border crossing at Ressano Garcia-Lebombo post with South Africa is expected to be completed by the end of 2011, and unified vehicle inspections and processing for both countries is planned for 2012. The GoM has signed agreements with Zimbabwe, Malawi and Tanzania to create one-stop border posts with those countries in 2012 and 2013. The GPSE will support expanding the single window for business creation, operationalizing the online customs portal and implementing the first one-stop border post with South Africa.

### ***Sub-component Iib: Improve SME access to financial services and skilled human capital***

**4.2.14 *Recent Achievements:* The GoM undertook a series of initiatives to increase the supply of credit and skilled human capital in recent years, in part with the support of the Bank and other donors.** The ongoing Financial Sector Technical Assistance Project (FSTAP)—partially financed by the Bank—has supported a series of reforms, including a new banking supervision law, the creation of three commercial courts, and implementation of International Financial Reporting Standards. The GoM launched the Economic Rehabilitation Fund (FARE) in 2005, also financed in part by the Bank, to act as a second-tier lender to rural microfinance institutions (MFIs). FARE has shown notable success in expanding credit to the rural poor, for example by providing incentives for banks and MFIs to open in districts with no financial services and promoting the use of “banks on wheels” to service markets in remote areas. To improve the availability of skills relevant to the work force, the GoM in 2006 launched the Professional Skills Reform Program (PIREP) with the support of several donors to improve the coordination of technical and vocational education and training (TVET) provision and to involve the private sector in designing curricula.

**4.2.15 *Current Challenges:* Access to credit and skilled human resources remains a major obstacle to broadening the impact of economic growth on the wellbeing of poorer Mozambicans.** According to the World Bank’s 2009 Investment Climate Assessment (ICA), only 13% of firms had access to credit lines and the vast majority of banking and credit activity was concentrated in the Maputo area among large businesses. The ICA highlighted information gaps as a critical area to be addressed, notably the lack of reliable credit bureaus, the unsuitability of the Central Bank’s credit registry for use by banks to assess potential borrowers and an inappropriate regulatory framework limiting the ability of MFIs to offer credit. On TVET, advances in the PIREP project have been promising but slow, the necessary institutional and legal framework to coordinate numerous dispersed training initiatives is lacking and interface with the private sector on needed skills remains limited.

**4.2.16 *Reform Agenda Going Forward:* Mozambique has a number of policy reforms planned in the area of credit and skills, including credit bureaus, the regulatory framework for MFIs and the new TVET system.** The Central Bank is studying the creation of private credit bureaus to increase the information flow to private lenders, and is expected to propose legislation in late 2012. The Central Bank plans to improve credit registry reporting in 2012, disaggregating by type of bank and sector/size of borrower. Key steps for expanding the access of SMEs and rural areas to credit will be to improve the regulatory framework governing MFIs, which is also under Central Bank consideration as part of the recently-completed Financial Sector Development Strategy to 2020. The main focus of TVET reforms is to create a unified National Professional Education Authority (ANEP) to take the place of the existing provisional framework divided among several ministries. Legislation is expected to enter Parliament by the end of 2011, with the ANEP to begin functions in early 2013. A system of Labor Market Information Observatory is to begin operations in 2013 to compile information on labor market characteristics and needed skills, which will provide ANEP continual feedback to keep TVET curricula relevant to the private sector. The GPSE operation will support revising the regulations for MFIs, creating the ANEP and establishing the Labor Market Information Observatory system.

## **4.3 *Financing needs and arrangements***

**4.3.1 The proposed GPSE loan is part of the G19 budget support to close the 2011-2013 fiscal gap and provide additional fiscal space to promote long-term poverty reduction and sustained economic growth.** Public spending was kept under control and fiscal revenues have increased in recent years as a result of the GoM’s efforts to reduce evasion and expand the tax base. More

recently, several factors are exerting additional pressures on fiscal accounts: (i) lower domestic currency value of donor support in light of the recently appreciated exchange rate; (ii) the current inflationary environment requiring fiscal policy to be overly supportive of disinflation; (iii) increased costs of the fuel subsidy in 2011 resulting from the agreement signed with fuel importers in January 2011; and (iv) the need to provide additional fiscal resources to new emergency expenditures to preserve social peace.

**Table 4: Government Fiscal Needs (in US\$ million)**

	2010	2011	2012 1/	2013 1/
Total revenue (excl. grants)	1,921	2,444	2,781	3,186
Total expenditure and net lending	3,077	4,102	4,644	5,210
Overall balance, before grants	-1,156	-1,658	-1,863	-2,023
Grants	794	883	945	1,057
o.w. budget support (incl. EU and DfID)	363	339	365	393
<b>Overall balance, after grants</b>	<b>-363</b>	<b>-774</b>	<b>-918</b>	<b>-966</b>
Net domestic financing	-59	72	135	136
Net external financing	421	702	783	831
Project	235	254	270	347
Non-project	216	484	581	604
Loan to public enterprises	103	372	469	453
Budget support (loans)	113	112	112	...
<b>o.w. World Bank</b>	<b>82</b>	<b>85</b>	<b>85</b>	<b>...</b>
<b>AfDB</b>	<b>31</b>	<b>27</b>	<b>27</b>	<b>27</b>
<b>Memo items:</b>				
Budget support received	470	...	...	...
Overall balance, incl. grants (% of GDP)	-3.7	-6.4	-6.8	-6.4

Note: 1/ Based on projections from the Ministry of Planning and Development and IMF. Source: Ministry of Finance, Ministry of Planning and Development and IMF.

**4.3.2 The GoM has responded proactively to these new fiscal challenges.** Measures to ensure fiscal sustainability/austerity and to increase targeting of social protection programs are being launched. In late April 2011, the GoM submitted a revised budget law to Parliament reducing the overall spending envelope through several austerity measures, including gradually removing the fuel subsidy. Since consolidation of these efforts will be progressive, GPSE financing is instrumental to assist the GoM overcome short-term fiscal needs.

**4.3.3 Over the medium term, the GPSE loan will contribute to sustain the GoM's efforts to foster economic growth through stepped-up public infrastructure investment.** This is essential to help Mozambique achieve its development needs and close infrastructure gaps. The projected 2011-213 fiscal gap to be financed by budget support assistance amounts to about US\$400 million per year (Table 4). GPSE support will be key to help maintain macroeconomic stability and ensure public debt sustainability. In the medium term new sources of fiscal space are expected to grow as a result of new mega-project activity in the natural resource sector.

#### **4.4 Program beneficiaries**

**4.4.1 In light of the broad set of policies encompassed in the proposed operation, the beneficiaries are expected to be the Mozambican population as whole, in particular small-scale private sector operators and their employees and youths.** The overall thrust of the policy program supported by the GPSE is to make Mozambique's growth more inclusive, providing more employment and income opportunities to the entire population. Specific groups expected to directly benefit include: SME owners and their employees due to smoother bureaucratic requirements for business and trade, greater access to credit and a better-trained workforce; rural businesses and

individuals due to expanded rural micro-lending, PPP-led transport and service infrastructure and local distribution of revenues from resource extractive industries; foreign and domestic investors due to a reliable and transparent legal and regulatory framework; and taxpayers through strengthened management of public finances and greater revenue from mega-project concessions.

#### **4.5 Impacts on gender**

**4.5.1 Mozambique is relatively advanced regarding the participation of women in economic and political activity, but further measures are called for in particular regarding health issues, which this operation supports indirectly through the PAF.** As part of the PAF action plan—the satisfactory completion of which is a disbursement trigger for the second and third tranches of this operation—the GoM is committed to further progress on health services related to maternal care and support to women with HIV/AIDS. Specifically related to this operation, policies supporting access finance and skills development will devote special attention to women, especially from disadvantaged vulnerable groups, in conjunction with the Bank’s ongoing Women Entrepreneurship Skills Development project. Finally, broader improvements to the business environment for SMEs, though not specifically linked to gender, are expected to yield benefits to female entrepreneurs and employees.

#### **4.6 Environmental impacts**

**4.6.1 The GPSE was classified category III in June 2011 according to Bank’s procedures for the environmental and social impact assessment,** which implies that it will not have any direct negative environmental impact. A Pilot Program for Climate Resilience, financed by the Climate Investment Fund, is undertaking an environmental assessment to inform GoM policy reforms related to infrastructure projects, including those that may come as a result of changes to PPP legislation supported by this operation. The Environment Ministry is currently undertaking a strategic environmental assessment of the coastal zone, funded in part with donor support. The Danish government is currently finalizing a new national environment program to strengthen the ministry’s ability to perform adequate environmental assessments, and the World Bank has a sectoral budget support operation planned for 2012 to strengthen ministry functions. All of this is expected to help address possible issues occasioned by proposed infrastructure projects and resource concessions.

## **V. IMPLEMENTATION, MONITORING AND EVALUATION**

### **5.1 Implementation arrangements**

**5.1.1 *Responsible institution:* The executing agency for GPSE will be the Ministry of Finance (MF).**

**5.1.2 *Disbursements:* The Bank loan amounting to UA 60 million for three fiscal years (2011-2013) will be disbursed in three tranches according to a schedule directly requested by the GoM to respond to their fiscal needs. The *first tranche* of UA 20 million will cover 2011 budget requirements and will be disbursed upon the entry into force of the Loan Agreement and fulfillment of the conditions precedent to the first disbursement. The disbursement of the *second and third tranches* of UA 20 million each will occur in 2012 and 2013 and will be considered after the satisfactory reviews of program execution, and subject to GoM satisfying the conditions stipulated in Section 6 of this report. The three tranches loan proceeds will be credited to a designated United States dollar account that will be opened in the name of the Treasury in accordance with the Bank’s Disbursement Letter.**

5.1.3 *Procurement:* **The current procurement system is deemed to be adequate to support the proposed operation.** CPAR and PEFA assessments from 2008 to 2010 found that Mozambique has made significant progress in developing a sound procurement system. However, the CPAR identified further improvements to be made in operations and market practices, including better public sector interaction with the business sector, improved access to credit and public procurement, streamlined approval and record management systems and improved contract management practices as well as internal controls and complaint mechanisms. The GPSE operation will support GoM's efforts to achieve these improvements.

5.1.4 *Fiduciary environment:* **The fiduciary framework is adequate to support the proceeds under the proposed program,** particularly in light of the progress made in the PFM reform program being undertaken and can be relied upon for the efficient and economical utilization of program funds.

5.1.5 *Audit:* **The Administrative Tribunal will annually audit the General State Account (CGE) including the Bank's contribution.** The audit report will be sent to the Bank. An audit of the funds flow in the program designated account will be done in accordance with the Annex 7 of the MoU signed between the GoM and the G19 (including the Bank). The audit report and the management letter together with management response will be submitted annually to the G19, no later than six months after year end.

## **5.2 *Monitoring and evaluation arrangements***

5.2.1 **The Directorate of Investment and Cooperation within the MPD will be the primary counterpart for the Bank,** and will facilitate the data required for monitoring the program. The Bank will monitor progress of the proposed operation in coordination with Mozambique's main DPs. It will maintain dialogue with counterparts in MPD; the ministries of Finance, Commerce, Mining Resources, Labor and Education; the Bank of Mozambique; tax and customs authorities; and other offices critical to the success of the program. Periodic monitoring by the Bank will take place during semiannual field missions, while the country economist will undertake more frequent in-country monitoring. The key tenets governing evaluation are considered in the MoU signed by the GoM and program donors in 2009. The GoM and the G19 share responsibility for monitoring the implementation of mutually agreed indicators through bi-annual joint reviews. The Performance Assessment Framework (PAF) has shown good results as an assessment tool. At the end of the program, a Program Completion Report will be prepared.

## **VI. LEGAL DOCUMENTATION AND AUTHORITY**

### **6.1 *Legal documentation***

6.1.1 **The financing instrument used for this operation is an African Development Fund (ADF) loan of UA 60 million in the form of budget support to the Republic of Mozambique from the ADF's resources.** The loan will be disbursed in three tranches, upon fulfillment of the conditions outlined below.

### **6.2 *Conditions associated with Bank Group intervention***

6.2.1 **This program uses prior actions and tranche disbursement conditions based explicitly on the PAF framework for budget support agreed on between the GoM and the G19 donors, and following the same design as the successful PRSL II loan.** As with the PRSL, this operation uses two specific policy actions to be completed prior to Board approval, both considered critical to the GPSE's goals and taken directly from the PAF policy matrix agreed on each year between the

donors (including the Bank) and the GoM. The condition of the second and third tranche disbursements is linked to overall GoM progress on the PAF policy framework, as well as two policy actions considered critical to GPSE program goals. Overall progress on the PAF will be verified via the Aide Memoire by G19 donors and the GoM at the conclusion of the annual joint review process, normally in April or May of each year. These arrangements are fully consistent with the 2009 MoU signed between the G19 donors and the GoM, which stipulates the modalities of conditionality for budget support operations.

**6.2.2 Prior Actions:** Two policies were selected from the reform agenda to serve as prior actions to be completed before Board presentation. The two policy actions pertain to PFM reforms supported by the previous PRSL loan series, to support continuity of these reforms (Box 3), and were taken directly from the PAF development policy framework agreed upon between the G19 donors and the GoM. The MoU between the G19 and the GoM, to which the Bank has subscribed, stipulates that policy conditions for budget support operations are to be drawn from the PAF framework.

**Box 3: Prior Actions for Board Presentation of the GPSE (by August 15<sup>th</sup> 2011)**

**Prior Action #1:** The Government has, through the Ministry of Finance, ensured that the total value of budgetary spending using direct execution via e-SISTAFE is at least 37% in the FY 2010 budget execution.

**Prior Action #2:** The Government has, through its Court of Accounts, ensured that the percentage of the budget covered by the external audit in accordance with norms is 37% in the FY 2010 budget execution.

**6.2.3 Entry into force of the Loan Agreement** shall be subject to fulfillment of the provisions of Section 12.01 of the General Conditions.

**6.2.4 Conditions precedent to disbursement of the first tranche:** The obligation of the ADF to disburse the first tranche of the loan, in an amount of UA 20 million, shall be conditional to entry into force of the Agreement and fulfillment of the following conditions:

- i. The maintenance by the Borrower of an appropriate macroeconomic framework (required evidence: either the annual IMF Article IV consultations, IMF reviews of Mozambique's economic program under the PSI, or on an IMF specific comfort letter), and;
- ii. Provide evidence to ADF of the existence of a Treasury account designated to receive budget support resources, including GPSE proceeds, in a bank acceptable to the ADF.

**6.2.5 Conditions precedent to disbursement of the second tranche:** The obligation of the ADF to disburse the second tranche of the loan, in an amount of UA 20 million, shall be conditional to the following conditions:

- i. The maintenance by the Borrower of an appropriate macroeconomic framework (required evidence: either the annual IMF Article IV consultations, IMF reviews of Mozambique's economic program under the PSI, or on an IMF specific comfort letter);
- ii. Provide evidence to the ADF that the 2012 Aide Memoire of the joint review of the 2011 Performance Assessment Framework (PAF), issued by the Borrower and donors, indicates the achievement of an overall satisfactory performance of the 2011 PAF;
- iii. The GoM is to provide evidence of the Action Plan for the implementation of the Extractive Industries Transparency Initiative (EITI) for the period 2011-2013 endorsed by the EITI National Coordination Committee (see paragraph 4.2.9). Required evidence: letter from the Minister of Planning and Development attaching the Action Plan.

**6.2.6 Conditions precedent to disbursement of the third tranche:** The obligation of the Fund to make the disbursement of the second tranche of the loan, in an amount of UA 20 ADF, shall be conditional to the following conditions:

- i. The maintenance by the Borrower of an appropriate macroeconomic framework (required evidence: either the annual IMF Article IV consultations, IMF reviews of Mozambique's economic program under the PSI, or on an IMF specific comfort letter);
- ii. Provide evidence to the ADF that the 2013 Aide Memoire of the joint review of the 2012 PAF, issued by the Borrower and donors, indicates the achievement of an overall satisfactory performance of the 2012 PAF;
- iii. The GoM is to provide evidence that the One-Stop Shops (OSS) for business creation and other services at the district level have been extended by at least four (4) offices in 2012 (see paragraph 4.2.13). Required evidence: either the 2013 Aide Memoire of the joint review in 2012 evidencing that this condition has been met or a letter from the Minister of Planning and Development indicating the district where at least four OSS offices have been physically established.

6.2.7 **Undertakings:** (i) Within a period of two days as of fund disbursement, the Borrower undertakes to transfer those amounts to the Transit Account of the Ministry of Finance in Metical equivalent without any commission charges; (ii) the Borrower undertakes to provide confirmation within three business days.

### 6.3 *Compliance with Bank Group policies*

6.3.1 **This program complies with all applicable Bank Group policies and guidelines, including:** (i) 2004 Guidelines for DBSL operations; (ii) Bank's GAP 2008-12; (iii) Environmental and Social Assessment Procedures; and (iv) policies on cross-cutting issues.

## VII. RISKS MANAGEMENT

7.1 **The stable macroeconomic panorama maintained by Mozambique in recent years could be impacted by a number of factors, both internal and external.** Internally, the GoM and/or the Central Bank could shift their currently solid policy stance to a more expansionary position, either through relaxed monetary policy or increased fiscal spending. Externally, the principal threats facing Mozambique are: (i) a sharp rise in food and oil prices, much of which Mozambique imports and which are partially subsidized by the GoM; and (ii) an unexpected decline in aid flows and/or FDI. **Mitigation:** *Authorities are receiving technical support from the IMF to maintain stable macroeconomic policies through a PSI. The GPSE program is supporting GoM financing needs and public sector spending efficiency to help ease the transition to more targeted subsidies of food and fuel, which should help ease fiscal risks of international price increases. Regarding aid flows, the PAF increases aid predictability and the GPSE is structured to provide reliable support over three fiscal years.*

7.2 **Inadequate control of corruption may impact the reform agenda, including efforts to maximize the benefits from PPPs, mega-projects and regional trade.** This is a particular risk in light of the expected upswing in the number and size of resource extraction projects in the coming years. **Mitigation:** *The GPSE program supports improved transparency and accountability of the internal use of government resources and the interactions between the public and private sectors. Specific measures addressed in the program relate to Mozambique moving ahead with its application to join the EITI, a stepped up program of internal and external audits of government fiscal accounts, and uniform competitive procedures for public procurement.*

7.3 **Further social instability following the September 2010 riots remains a considerable risk.** In addition to price increases for food and fuel, other triggers of political unrest could arise linked to the upcoming 2014 elections. **Mitigation:** *The program is promoting measures to increase revenue generation among the poor by stimulating employment, skills development and better*

*targeting of fiscal spending. The switch to targeted food and fuel subsidies will allow authorities to continue providing assistance to those most in need while still maintaining a stable fiscal position.*

**7.4 Inadequate fiduciary control systems, particularly at the district level, could delay reforms aimed at improving government fiscal capacity.** Limited institutional capacity is perceived to be a key constraint delaying implementation of reforms. **Mitigation:** *The Bank is supporting PFM systems both at the central and decentralized government levels. The Bank is also financing two institutional support projects (FSTAP, ISPPR) and ESW (PEFA Update, including action plan).*

## **VIII. RECOMMENDATIONS**

8.1 Management recommends that the Board of Directors approve the proposed Loan of UA 60 million from the resources of the African Development Fund to the Government of Mozambique in the form of a general budget support for the purposes and subject to the conditions stipulated in this report.

## Annex 1. Letter of Development Policy



**REPÚBLICA DE MOÇAMBIQUE  
MINISTÉRIO DA PLANIFICAÇÃO E DESENVOLVIMENTO  
GABINETE DO MINISTRO**

**Nr. /GM/MPD/11  
Maputo, September, 2011**

**Subject: Letter of Development Policy for the Growth and Public Sector Efficiency Program**

Maputo, June 17, 2011

1. I write on behalf of the Government of the Republic of Mozambique to request a loan in the amount of UAG0 million from the African Development Fund (ADF), to support continuing the reform program backed by the previous Poverty Reduction Support Loan (PRSL) I and PRSL II in the proposed Inclusive Growth and Public Sector Efficiency (GPSE) operation.
2. This Letter of Development Policy: (i) summarizes the Government's poverty reduction strategy envisaged in the new Poverty Reduction Action Plan (PARP) 2011-2014; (ii) describes recent developments and performance under the Government's economic and social development program of the Five-Year Government Plan and the Absolute Poverty Reduction Action Plan (PARPA) II poverty reduction strategy through April 2011, and; (iii) presents the Government's program, which is being submitted for support within the GPSE.
3. We commend the ADF on its continued support for the Government's poverty reduction and development program, intended to improve the standards of living of Mozambicans through reforms to improve the business environment and promote employment growth, and thereby make the country's economic growth more inclusive for all citizens. The GPSE general budget support program is designed within the framework of donor coordination outlined in the Memorandum of Understanding (MoU) between the Government and the G19 coordinating group of international aid partners, including the ADF, signed in March 2009.
4. The aforementioned loan will help to meet the financing requirements that Mozambique faces to implement the PARP 2011-2014 through the Economic and Social Plan (PES) and the annual budget for the three-year period 2011 to 2013.

## The Program

5. **The new four-year PARP adopted by the Council of Ministers on May 3, 2011 demonstrates the Government's commitment to more inclusive growth.** It aims at reducing poverty from 54.7% in 2009 to 42% by 2014 and lies in three main pillars: (i) the increase in production and productivity in the labor-intensive sectors of agriculture and fisheries; (ii) job creation through improvements in the business environment; and (iii) human and social development, including through the significant expansion of social protection systems. It will be embedded in two supporting pillars: (i) the maintenance of a sound macroeconomic framework; and (ii) our strong commitment to good governance.

6. **The Government designed the PARP as a dynamic and flexible document.** Its objectives and indicators will be reviewed and, if needed, updated annually under the PES in light of national and international developments and in tandem with the implementation of sectoral strategies, such as the forthcoming Agricultural Reform Strategy, the Financial Sector Development Strategy, and the successor program to the 2008-12 Strategy for the Improvement of the Business Environment in Mozambique.

7. **The PARP complements the Government's overall approach to economic development, as laid out in the Five-Year Plan 2010-2014.** Its strong focus on fostering social cohesion will be conducive to supporting the Government's objective of promoting long-term economic growth and complement the intention to further exploit Mozambique's rich endowment of natural resources and rapidly develop public infrastructure. In this context, the Government will continuously seek to create fiscal space, including by improving the management of revenues from the natural resources sector so as to help finance the closing of the infrastructure and skills gaps and the expansion of social safety nets. The PARP aims at building sustainable social safety nets to help reduce poverty while strengthening Mozambique's long-term growth potential.

## Overview of Recent Progress

8. **The implementation of the PARPA II poverty reduction strategy in 2009 and 2010 was broadly satisfactory, as evidenced by the Joint Reviews with aid partners in May 2010 and May 2011, respectively.** Mozambique continues to show resilience in a turbulent external economic environment. Our economy has weathered the global financial crisis well. Real GDP growth in 2010, at an estimated 7%, fell slightly below expectations but was one of the highest in the region. Economic activity was broad-based and supported by strong global demand. Higher megaproject exports offset the rising import bill related to surging fuel and food prices and helped keep the current account deficit well below expectations. However, the recent increases in food and fuel prices, through their secondary effects, prevented core inflation from reversing its upward trend, despite our determined efforts to tighten monetary and fiscal policies. Remarkably strong revenue collections were instrumental in containing the primary domestic fiscal deficit to 3% of GDP, some 1% of GDP lower than programmed, notwithstanding higher outlays for the fuel subsidy and emergency spending to mitigate the impact of higher food prices on the poor.

9. **On the social front, progress has also been notable in health, education and social assistance.** The percentage of newborns with medical assistance rose to 62% in 2010 from 55% in the previous year, and the number of HIV-infected women receiving anti-retroviral treatment to prevent transmission to newborns has risen as well. The percentage of children attending primary school was 92% in 2010, up from the previous year and well above the 71% registered a decade previously. As well, the enrollment of girls in primary schools has continued rising as well and now represents 82% of male enrollment. The number of children, disabled and female household heads receiving social assistance increased in 2010 by over 25% to 264,000. Agriculture extension services expanded to reach 432,000 farmers in the country, up from 378,000 in 2009. Nonetheless results in poverty reduction have been disappointing; with 2009 results indicating that the poverty headcount rate had stagnated at 54%, after declining steadily up to 2003.

10. **The Government's program supported by the proposed GPSE operation includes two components that are an integral part of the wider PAF, PES and PAF frameworks.** They are:

### **Public Sector Efficiency and Transparency**

11. **The Government is committed to consolidate PFM and public sector efficiency and accountability reforms.** The PFM systems have shown major improvements in recent years, which have been supported by the Bank's previous PRSL I and PRSL II. Improving the reporting, monitoring, and control of budget execution remains a fiscal reform Government priority:

- *Expanding budget coverage.* The roll out of the e-SISTAFE budget execution system will continue, with a view to completing it for all Government institutions over the next few years. To this effect, the Government aims to adopt by end-September 2011 a roll out plan for the remaining budgetary entities that are currently not covered. To be cost effective, the Government will exclude entities from the roll out provided their spending and number of transactions fall below a threshold to be defined. By end-December 2011, e-SISTAFE will cover 45% of all spending and a total of 50 institutions.
- *Integrating all public finance IT systems.* By end-August 2011, we will adopt an IT master plan to support e-SISTAFE and other PFM components. It will provide a medium-term road map on IT priorities, define basic operating and hardware standards, and assess costs and risks associated with the expansion of electronic budget execution processes.

12. **A second key priority is to strengthen the transparency of public accounts.** This involves in particular a focus on increasing the level and reliability of internal and external audits, both at the central and provincial levels. The number of audits by the independent Administrative Tribunal (TA) has grown steadily in recent years, from five in 2003 to nearly 500 in 2009. Our intention is to reach a level of 40% of budget expenditure reviewed by the TA by the end of 2011.

13. **To improve the use of public finances to promote inclusive economic growth, the Government is planning a number of measures.** First, new procurement requirements for small bidders are being designed to open up public business to more Mozambican SMEs, a process that should be completed during 2012. Second, the procedure for prioritizing public investments for leveraging private resources through public-

private partnerships (PPP) are being streamlined through a new committee focused on public investment and by the passage of a new law on PPPs and concessions, both expected to be completed by the end of 2011. Lastly, the Government—well aware of the dangers many countries have faced when undergoing a boom in resource-extractive industries—is in the process of joining the Extractive Industries Transparency Initiative (EITI). We expect soon EITI a complain member, simultaneously we will continue to improve the transparency of natural resource revenues. Following the first EITI audit report recommendations, we intend to (i) assess and, if necessary, improve procedures on the valuation of minerals; (ii) determine whether capital gains can be considered as source of revenue, in line with best international practice; and (iii) undertake a study to define a proper tax allowance regime that clearly differentiates between depreciation and capital allowances in the context of fiscal mining regulation, with technical assistance sought from the IMF.

14. **The Government acknowledges the importance of ensuring adequate governance standards in promoting the business environment and relations with development partners.** The Attorney General's Office approved the Strategic Plan for the Central Bureau for the Fight against Corruption (GCCC) in January 2011.

### **Business Creation, Skills and Technology**

15. **The Government is fully committed to a promoting a more business-friendly environment in the interests of broadening the impacts of economic growth such that they have a greater impact on ordinary citizens.** To do so, our intention is to take reform measures that simplify the creation of new businesses, promote linkages between SMEs and larger mega-projects, facilitate access to credit and international trade, and help build the human capital skills necessary to prepare the Mozambican labor force to compete in the regional economic context. We see our natural resource and agricultural potential as well as our strategic geographic location in southern Africa as stepping stones to more inclusive economic growth, and seek support in implementing measures that will make that vision a reality.

16. **The Government is committed at easing bureaucratic restrictions on opening and closing businesses, which currently are time-consuming and inhibit new business creation.** An exhaustive study of all requirements to open a business is currently underway with a view to informing the design of a package of reforms to simplify these procedures, which are to be completed by the end of this year. This will likely involve the design of a "one stop shop" for business creation. A new bankruptcy law will be enacted, which will not only facilitate the orderly closure of non-viable enterprises, but also give security to bank lenders, which in turn can will facilitate access to credit —another priority area for economic development. The creation of a new credit bureau and the expansion of microcredit lending, particularly in rural areas, are part of this agenda.

17. **Mozambique's strategic location provides landlocked neighboring countries access routes to seaports.** The border post at Ressano Garcia-Lebombo is one of the busiest in the region. The Government is committed to consolidate Mozambique as a regional trade hub by leveraging improved cross-border trade facilitation and will be supported by GPSE. The Government is focusing on the border with South Africa to ease

trade with its most economically active partner through a one-stop border bureau and an electronic window for all customs transactions. The design of a new technical and vocational training authority is well underway with the support of various donors, and is expected to become operational in 2012. The goal is to improve professional training both to offer greater opportunities to motivated Mozambican workers and to provide the human capital businesses need to grow.

18. In sum, the Government intends to continue maintaining a sound macroeconomic framework to encourage economic growth, and take further reform actions with a view to broadening the pro-poor impact of that growth, such that it has a positive impact on the wellbeing of all Mozambique citizens. Therefore, we request that the ADF approves the proposed loan to support the implementation of the policy agenda.

Accept, Mr. President, the assurances of my highest consideration,

Sincerely,

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

**Dr. Donald Kaberuka**  
**President**  
**African Development Bank**  
**Tunis**

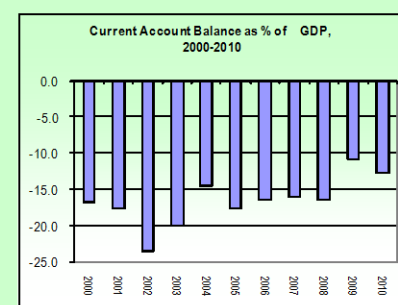
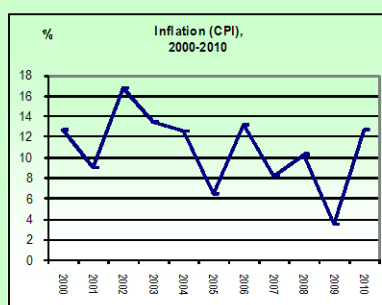
**Annex 2. Operation Policy Matrix (Prior Actions and Disbursement Conditions in for GPSE in Bold)**

Specific Policy Objectives	Strategic Reform Measures	Time Frame	Responsible Agency	Bank CSP Pillar
<b>1- Enhance Public Sector Efficiency and Transparency</b>				
Enhance the public finance management framework	<b>1. Expand the rollout of direct budget execution through e-SISTAFE</b>	2011-2013	MF, e-SISTAFE Coordination Committee	<b>Governance in Support of Inclusive Growth</b>
	2. Expand the coverage of the internal audit bodies	December 2011	IGF	
	<b>3. Expand the coverage of external audits of the state budget conducted by the TA</b>	2011-2013	Court of Accounts	
	4. Place complete budget online	December 2012	MF, CFMP	
	5. Approve and implement new salary policy and harmonize databases	December 2013	MF	
	6. Integrate all public financial IT systems	December 2012	MF	
Make partnerships between the public and private sectors more inclusive and transparent	7. Issue regulations on the law covering public-private partnerships (PPP) and concessions	December 2011	Cabinet	
	<b>8. Complete an Action Plan for the implementation of the EITI initiative for the period 2011-2013 as endorsed by the EITI National Coordination Committee</b>	December 2011	EITI Mozambique Secretariat, Ministry of Mining Resources	
	9. Submit the first EITI report to the international EITI secretariat; begin second and third report	December 2011; November 2012 and Nov. 2013	EITI Mozambique Secretariat, Ministry of Mining Resources	
	10. Revise decree on procurement procedures to ease the requirements for small bidders and disseminate	2011-2012	Cabinet, MF	
	11. Increase prosecution of corruption cases by Attorney General and publish statistics	2011-2013	PGR	
<b>2 - Improve the Environment for Business and Employment Creation</b>				
Simplify business procedures and	12. Revise the decree relative to the one-stop shops for creating enterprises	2012	Cabinet	

facilitate trade to promote job creation	<b>13. Extend coverage of one-stop shops for businesses at the district level to at least 4 offices</b>	December 2012	Commerce Ministry	<b>Infrastructure Development Promoting Social Inclusion and Economic Competitiveness</b>
	14. Operationalize the electronic single window customs management	2011-2013	Customs Administration, MF	
	15. The one-stop border shop on the Mozambique-South Africa border is operational	2012	Customs Administration, MF	
	16. Implement E-Taxation system for VAT and simplified regimen for SMEs	December 2012	Tax authority, MF	
	17. Eliminate stamp tax obligations on administrative acts	December 2012	Tax authority, MF	
	18. Achieve at least 75% of main roads in reasonable transit condition	December 2012	ANE	
	19. Undertake environmental assessment related to infrastructure and resource extraction projects.	December 2012	Environment Ministry	
Improve SME access to financial services and skilled human capital	20. Approve draft legislation on the organization of the credit bureau by the Bank of Mozambique	December 2012	BoM	
	21. Revise regulations on activities of microfinance institutions.	December 2013	BoM	
	22. Move financial sector regulation toward Basel II standards	2013	BoM	
	23. Implement International Financial Reporting Standards for large and medium-sized firms	December 2012	MF, BoM	
	24. Create the National Professional Education Authority (ANEP) for TVET	December 2013	Education Ministry, PIREP, Cabinet	
	25. Create Observatory and Labor Market Information System	December 2013	Cabinet	

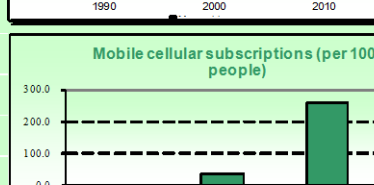
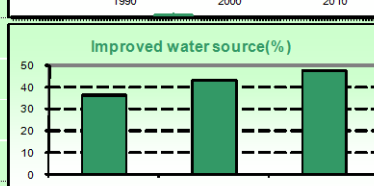
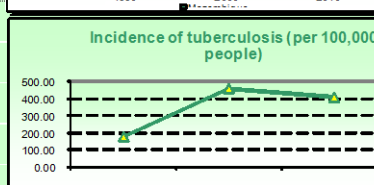
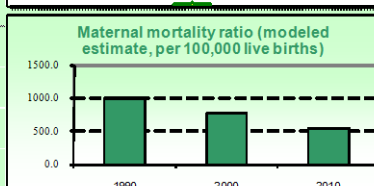
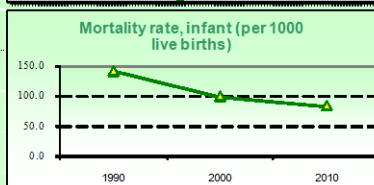
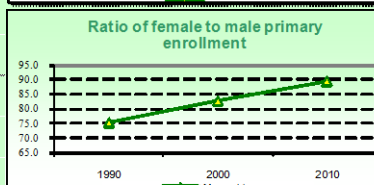
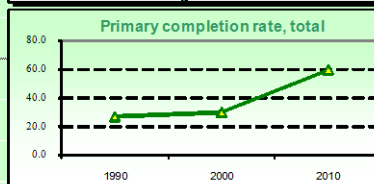
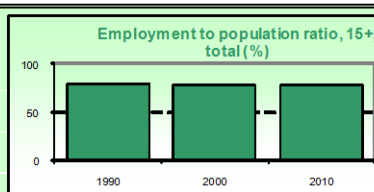
### Annex 3. Mozambique: Selected Economic and Financial Indicators, 2000-2010

Indicators	Unit	2000	2005	2006	2007	2008	2009	2010 (e)
<b>National Accounts</b>								
GNI at Current Prices	Million US \$	4,017	6,219	6,472	7,445	9,239	9,696	...
GNI per Capita	US\$	230	290	310	340	380	440	...
GDP at Current Prices	Million US \$	4,183.1	6,578.5	7,095.9	8,035.6	9,891.0	9,787.9	11 163.6
GDP at 2000 Constant prices	Million US \$	4,183.1	6,386.9	6,941.4	7,446.9	7,955.6	8,468.4	9 151.8
Real GDP Growth Rate	%	14.7	8.4	8.7	7.3	6.8	6.4	8.1
Real per Capita GDP Growth Rate	%	11.7	5.7	6.1	4.8	4.4	4.1	5.7
Gross Domestic Investment	% GDP	31.0	18.7	17.7	16.1	15.7	20.5	24.0
Public Investment	% GDP	9.2	8.6	11.7	9.8	8.7	12.3	16.0
Private Investment	% GDP	21.7	10.1	5.9	6.3	7.0	8.2	8.0
Gross National Savings	% GDP	15.1	8.4	7.6	7.2	4.4	9.5	12.0
<b>Prices and Money</b>								
Inflation (CPI)	%	12.7	6.4	13.2	8.2	10.3	3.5	12.7
Exchange Rate (Annual Average)	local currency/US\$	15.2	23.1	25.4	25.8	24.3	27.5	34.0
Monetary Growth (M2)	%	74.2	28.8	19.9	22.8	22.0	26.7	...
Money and Quasi Money as % of GDP	%	35.4	36.1	36.5	38.9	41.0	46.4	...
<b>Government Finance</b>								
Total Revenue and Grants	% GDP	18.5	20.0	24.9	25.0	25.3	27.0	26.6
Total Expenditure and Net Lending	% GDP	23.7	23.5	25.5	27.3	28.0	32.0	32.0
Overall Deficit (-) / Surplus (+)	% GDP	-5.3	-3.5	-0.5	-2.4	-2.7	-5.1	-5.4
<b>External Sector</b>								
Exports Volume Growth (Goods)	%	19.9	1.7	4.3	-5.4	5.3	-6.9	3.6
Imports Volume Growth (Goods)	%	-13.7	11.9	5.3	0.9	19.2	8.6	3.2
Terms of Trade Growth	%	4.8	5.4	15.1	3.1	1.3	4.9	16.6
Current Account Balance	Million US \$	-696.9	-1,158.2	-1,167.5	-1,295.1	-1,621.7	-1,063.3	-1,417.1
Current Account Balance	% GDP	-16.7	-17.6	-16.5	-16.1	-16.4	-10.9	-12.7
External Reserves	months of imports	4.4	3.1	2.7	3.0	2.7	3.7	3.2
<b>Debt and Financial Flows</b>								
Debt Service	% exports	74.2	9.7	70.7	8.5	8.5	20.0	17.1
External Debt	% GDP	143.0	88.1	64.1	61.4	48.8	51.8	48.9
Net Total Financial Flows	Million US \$	1,175.8	1,288.6	1,619.6	1,807.9	1,888.9	2,036.1	...
Net Official Development Assistance	Million US \$	906.2	1,297.0	1,605.7	1,778.1	1,996.1	2,013.3	...
Net Foreign Direct Investment	Million US \$	139.2	107.9	153.7	427.4	591.6	881.2	...



## Annex 4. Progress Towards MDG Fulfillment

Goal 1: Eradicate extreme poverty and hunger	1990 <sup>1</sup>	2000 <sup>2</sup>	2010 <sup>3</sup>
Employment to population ratio, 15+, total (%)	79.9	78.2	77.9
Malnutrition prevalence, weight for age (% of children under 5)	...	21.2	...
Poverty headcount ratio at \$1,25 a day (PPP) (% of population)	...	74.7	...
Prevalence of undernourishment (% of population)	59.0	44.0	...
Goal 2: Achieve universal primary education			
Literacy rate, youth female (% of females ages 15-24)	...	50.0	62.1
Literacy rate, adult total (% of people ages 15 and above)	...	48.2	54.0
Primary completion rate, total (% of relevant age group)	26.4	29.5	59.4
Total enrollment, primary (% net)	44.0	70.8	92.3
Goal 3: Promote gender equality and empower women			
Proportion of seats held by women in national parliaments (%)	16.0	30.0	34.8
Ratio of female to male primary enrollment	75.5	82.9	89.6
Ratio of female to male secondary enrollment	56.6	69.8	81.8
Goal 4: Reduce child mortality			
Immunization, measles (% of children ages 12-23 months)	59.0	60.0	67.0
Mortality rate, infant (per 1,000 live births)	140.4	99.1	83.3
Mortality rate, under-5 (per 1,000)	242.2	169.8	140.2
Goal 5: Improve maternal health			
Births attended by skilled health staff (% of total)	...	47.7	...
Contraceptive prevalence (% of women ages 15-49)	...	16.5	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	1000.0	780.0	550.0
Goal 6: Combat HIV/AIDS, malaria, and other diseases			
Incidence of tuberculosis (per 100,000 people)	181.0	460.0	409.0
Prevalence of HIV, female (% ages 15-24)	...	...	8.5
Prevalence of HIV, male (% ages 15-24)	...	...	2.9
Prevalence of HIV, total (% of population ages 15-49)	...	16.0	12.5
Goal 7: Ensure environmental sustainability			
CO2 emissions (kg per PPP \$ of GDP)	0.4	0.4	0.3
Improved sanitation facilities (% of population with access)	20.0	32.0	17.0
Improved water source (% of population with access)	36.0	43.0	47.0
Goal 8: Develop a global partnership for development			
Net total ODA/OA per capita (current US\$)	73.6	61.2	87.9
Internet users (per 1000 people)	...	6.8	26.8
Mobile cellular subscriptions (per 1000 people)	...	34.9	260.8
Telephone lines (per 1000 people)	3.5	3.4	3.2



## **Annex 5. IMF Public Information Note**

### **IMF Executive Board Concludes 2011 Article IV Consultation with Mozambique**

Public Information Notice (PIN) No. 11/82 (Summary)

On June 17, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mozambique.

[...]

#### **Executive Board Assessment**

Executive Directors commended the authorities for prudent policies that have resulted in a strong economic performance. Directors noted that, although Mozambique's medium-term prospects continue to be favorable, significant challenges remain in managing macroeconomic risks and ensuring that the benefits from growth are shared fairly across the population.

Directors underscored that safeguarding price stability and containing inflation expectations remain key policy priorities for the period ahead. In this regard, they supported the authorities' intention to tighten fiscal and monetary policies as needed to bring about an early and sustained decline in core inflation.

Directors welcomed the authorities' new Poverty Reduction Strategy (PARP). They supported the goals of broadening the country's productive and export base, creating additional employment opportunities, and expanding the social safety nets. Continued structural reforms to improve productivity and the business environment will be important to achieve sustained growth and poverty reduction. Directors encouraged the authorities to seek the expertise of development partners in designing well-targeted social protection systems.

Directors supported the authorities' prudent fiscal stance aimed at preserving macroeconomic stability and debt sustainability. They welcomed the authorities' intention to gradually phase out the fuel subsidy. With a view to creating fiscal space, Directors encouraged the authorities to sustain efforts to improve tax administration and seek new revenue sources. In particular, they encouraged the authorities to adopt a prudent approach to generating additional budgetary revenue from the natural resource sector while protecting Mozambique as a destination for foreign investment. Directors emphasized the importance of adhering to a prudent borrowing strategy, further strengthening debt management, and improving investment planning.

Directors noted the resilience of the banking system during the global crisis, and recommended continued vigilance in light of remaining vulnerabilities. In particular, Directors stressed the importance of adequate capital buffers at all banks, better diversified loan books, and a strict oversight of financial flows between banks and their parent companies abroad. They welcomed progress in establishing a crisis resolution framework and enhancing bank supervision, while noting the need for steps to make the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework more effective.

Directors welcomed the authorities' acceptance of the obligations under Article VIII of the Fund's Articles of Agreement.

**IMF EXTERNAL RELATIONS DEPARTMENT**

Press Release No. 11/240; Public Affairs Media Relations

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## Annex 6. Map of Mozambique

